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S. Hrg. 104–167

NAVY T-AO 187 KAISER CLASS OILER CONTRACTS

Y 4. G 74/9: S. HRG. 104-167

Navy T-AO 187 Kaiser Class Oiler Co...

HEARINGS

BEFORE THE

PERMANENT
SUBCOMMITTEE ON INVESTIGATIONS

OF THE

COMMITTEE ON
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

MAY 2 AND 4, 1995

Printed for the use of the Committee on Governmental Affairs

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NAVY T–AO 187 KAISER CLASS OILER CONTRACTS

TUESDAY, MAY 2, 1995

U.S. SENATE,
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS,
OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:03 a.m., in room 342, Dirksen Senate Office Building, Hon. William V. Roth, Jr., Chairman of the Subcommittee, presiding.

Senators Present: Senators Roth, McCain, Nunn, and Dorgan.

Staff Present: Harold Damelin, Chief Counsel and Staff Director; Eric Thorson, Chief Investigator; Carla J. Martin, Chief Clerk; Stephen H. Levin, Counsel; Christopher Greer, Investigator; Mary Ailes, Staff Assistant; Michael Bopp, Counsel; John H. Cobb, Counsel; Daniel S. Gelber, Chief Counsel to the Minority; Mary D. Robertson, Assistant Chief Clerk to the Minority; John Sopko, Deputy Chief Counsel to the Minority; Scott Newton, Minority Investigator; Mark Foreman (Senator Roth); Ginny Koops (Senator Roth); Claudia McMurray (Senator Thompson); Marty Grenn (Senator Cohen); Ron Indicott (Governmental Affairs); Creighton Green (Armed Services); Brian Dettelbach (Senator Glenn); Dale Cabiness (Senator Stevens); and Charlie Murphy (Senator Grassley).

OPENING STATEMENT OF CHAIRMAN ROTH

Chairman ROTH. The Subcommittee will come to order.

I have to report that at 11 a.m., there will be a series of votes. We are not certain at this stage how many, but it could be as many as 11. It is my intent to recess at that time for whatever period of time appears appropriate, and then we will reconvene at the end of that period and complete the hearings for today.

The Subcommittee is beginning this morning 2 days of hearings to review what has become a decade-long fiasco known as the Navy T–AO 187 Kaiser Class oiler contract.

I sat in this chair exactly 12 years ago tomorrow, when the Subcommittee previously examined the Navy's ship procurement process. At that time, I said, "This hearing should provide a new perspective on the continued defense debate, a hard look at how the Navy contracts and supervises shipbuilding at private facilities throughout the country. We in Congress need to know, and what American taxpayers demand to know, is this: Are we truly purchasing a dollar's worth of defense for every dollar we spend?"

Apparently, some things never change, for that is exactly why we are here again today, to attempt to bring about a change, a change

in the way the Navy procures its ships and a change in the mindset of how the Defense Department spends taxpayers' dollars.

This hearing is also about accountability. It is a great responsibility to be entrusted with the power to spend hundreds of millions of dollars that the taxpayers have contributed for the defense of this Nation. We must hold those individuals who have that important responsibility accountable for their actions. That is the task of an oversight committee and that is why we are here today.

In 1985, the Navy awarded a contract for two oiler ships, with options for two more, to the Penn Ship Company of Philadelphia at a cost of approximately $400 million, or about $100 million per ship. The contract was awarded despite great concern by the Navy about the contractor's financial capability to complete such a task.

The Navy's financial concerns resulted in the assets of Penn Ship being placed in a trust designed to protect the interests of the Navy in case the contract was terminated for default, and that is exactly what happened. The Navy terminated the contract for default. For the first time in nearly 20 years, a Navy ship was not completed.

Inexplicably, the Navy cancelled the trust agreement as part of the termination for default. A closer look at the trust agreement showed that the liens and mortgages on the various properties secured for the Navy were never filed, leaving the Navy unprotected. The Navy's financial interest was unsecured. Despite tens of millions of dollars owed by Penn Ship as a result of the default, the only thing the Navy received was a floating dry dock.

After terminating the contract, the Navy had the two partially-completed oilers towed out of Penn Ship Company's yard in December 1989. At that point, these two ships had cost the Navy over $300 million. Remember, under the original contract, four ships were to cost roughly $400 million total.

Our investigation has also revealed that, after terminating the contract for default, the Navy paid Penn Ship $45,000 per day, and $90,000 on holidays, for providing security for the ships and materials that remained at the yard but belonged to the Navy. The Navy continued to make these payments even after the ships were long gone and only left-over materials remained in the yard. Even though Penn Ship still owed the Navy millions of dollars, the Navy paid Penn Ship a total of $4.6 million more under this security arrangement.

In the final settlement of this matter, the Navy credited Penn Ship with $19 million for a dry dock, which our investigation indicates the Navy has never used. While the Navy is quick to explain that the dry dock is leased out, it appears that the Navy receives no money for the use of this $19 million asset.

Unfortunately, the saga does not end here. The contract to complete these two ships was not given to the company who had successfully built all the previous oilers, nor even to the low bidder. The contract was awarded to Tampa Shipyards, a company which was also in serious financial condition. Almost immediately, Tampa Shipyards showed signs of trouble.

The financial situation became so bad that suppliers would not deliver materials to the yard, prompting Tampa Shipyards owner George Steinbrenner to ask the Navy for a $25 million bailout. The Navy declined. Despite financial relief granted by the Congress,

Tampa Shipyards was soon back in dire financial trouble. After $102 million more of taxpayer dollars were paid to Tampa Shipyards, this contract, too, was terminated by the Navy for default.

The two unfinished ships are now rusting in the James River off Virginia. They will probably never be finished. Just last week, a settlement was reached on a suit filed by Tampa Shipyards against the Navy. Under the settlement, the Navy will pay an additional $18 million to Tampa Shipyards.

The bottom line of this hearing is that nobody appears to be looking out for the taxpayers' bottom line. The Navy spent about $450 million; the American taxpayer received no ships. That is $450 million spent and nothing but two rusting hulks to show for it. This case stands as a devastating indictment of the current state of the military procurement system.

This morning, we will hear from Derek Vander Schaaf, Deputy Inspector General of the Department of Defense, who will outline the report his office did on this matter.

We will also hear from two Navy captains, now retired, who had the task of overseeing these contractors. Both Captain Schrodt and Captain Klein advised the Navy that these two shipyards could not complete these ships. Had their recommendations been followed immediately, we probably would not be convening this hearing today, and there likely would be two more ships in the fleet.

On Thursday, May 4, we will receive testimony from officials of the two contractors, Penn Ship and Tampa Shipyards.

I want to thank our ranking member, Senator Nunn, for his cooperation and for his staff's assistance in this investigation. I look forward to continuing our tradition at PSI of working together to eliminate these indefensible examples of waste in our Nation's defense procurement system.

PREPARED STATEMENT OF SENATOR ROTH

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Apparently, some things never change for that is exactly why we are here again today—to attempt to bring about a change; a change in the way the Navy procures its ships, and a change in the mindset of how the Defense Department spends taxpayer's dollars.

This hearing is also about accountability. It is a great responsibility to be entrusted with the power to spend hundreds of millions of dollars that the taxpayers have contributed for the defense of this Nation. We must hold those individuals who have that important responsibility accountable for their actions. That is the task of an oversight committee and that is why we are here today.

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[1] "Irregularities in Navy Ship Procurement," hearing before the Permanent Subcommittee on Investigations, May 3, 1983.

nated for default. That is exactly what happened—the Navy terminated the contract for default. And for the first time in nearly 20 years, a Navy ship was not completed.

Inexplicably, the Navy cancelled the trust agreement as part of the termination for default. A closer look at the trust agreement showed that the liens and mortgages on the various properties secured for the Navy, were never filed, leaving the Navy unprotected. The Navy's financial interest was unsecured. Despite tens of millions of dollars owed by Penn Ship as a result of the default, the only thing the Navy received was a floating dry dock.

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On Thursday, May 4, we will receive testimony from officials of the two contractors, Penn Ship and Tampa Shipyards. We will conclude our 2-day hearing with representatives from the Navy.

I want to thank our Ranking Member, Senator Nunn, for his cooperation and for his staff's assistance in this investigation. I look forward to continuing our tradition at PSI of working together to eliminate these indefensible examples of waste in our Nation's defense procurement system.

Senator ROTH. Senator Nunn.

OPENING STATEMENT OF SENATOR NUNN

Senator NUNN. Thank you very much, Mr. Chairman. I thank you for having this hearing and I thank your staff for the excellent work they have done on this hearing.

Mr. Chairman, I remember in April of 1983, this Subcommittee met, and you were Chairman at that time and I was the ranking member at that time, and we had a hearing on irregularities in Navy ship procurement. That hearing focused on cost mischarging at a single shipyard.

Today, we will examine problems associated with a major ship procurement. It is with some irony that I note that the specific case study we will review today began its life cycle about the time of the 1983 hearing. The fact that we are here again is an illustration of the enormous complexity of the procurement process, the myriad figures and factors which play a part in that process, and the requirement for adequate pre- and post-award oversight.

I understand the staff investigation will show that poor pre-award evaluation took place. Improper planning, faulty construction, and poor contract oversight led to the point where the Navy is now the owner of two unfinished, unsalvageable, and unwanted tankers.

While each of the participants will have an opportunity to provide their view of events, it appears that there are enough problems in procurement to go around in terms of sharing the blame, but I wish to point out that there are other factors, including Congressional action which affected the Navy decision-making process and the shipbuilders. Decisions regarding dual sourcing and industrial mobilization base played critical roles in the original award and the subsequent transfer of the ships from Penn Ship to Tampa Shipyards.

The later decision by Congress to approve a bailout for several shipyards, including Tampa, in the 1993 Fiscal Year Department of Defense Appropriation Act went directly against the Navy's recommendation at that time. I spoke out against the bailout at that time. I subsequently requested an audit be conducted by the Department of Defense Inspector General to review how these bailout funds were used, and, of course, we did receive that.

Most importantly, there was a predilection during that time which favored accepting the lowest bid during the procurement process, even if it was not the best value to the Government. Decisions which resulted in any other outcome would have required extensive justification to Congress and the public.

But, as the investigation points out, low bid should be only one factor in determining what is the best value for the Government. These are not like ordinary procurement decisions, buying things off the shelf. We have learned from very expensive lessons over the years where it would have been more cost effective to award contracts to companies whose bids were higher but, nonetheless, offered better value, more realistic timetables and costs.

In other words, the capability to do the job is important in Government procurement. It is not simply the lowest cost, because if the contractor goes broke, then it does not matter how low the bid was, the Government is going to take a big hit.

So we have, I think, a lot of lessons here, but many of them, frankly, should have been learned a long time ago.

Accepting the concept of obtaining the best value versus the low bid requires a fundamental change in attitude here in Congress, as well as the Department of Defense, as well as the news media. Last

October, the Senate Armed Services Committee, which I chaired at the time, in conjunction with the Committees on Governmental Affairs and Small Business, worked together to pass the Federal Acquisition Streamlining Act of 1994. Mr. Chairman, you played a large role in that effort through your position on the Governmental Affairs Committee, along with six other Senators who are Members of this Subcommittee.

This Act, both directly and indirectly, addresses some of the issues raised here today, not all of them, but some of them. It is my hope, and certainly that, I am sure, of Secretary of Defense Perry, that the Act will assist in making the procurement system more efficient, flexible, and accountable. It will enhance the use of best-value procurements.

I trust these hearings will also assist in pointing out the faults in the system so that they may be addressed and corrected.

Let me conclude by stating I share your concerns regarding the need for accountability. In our current state of declining resources, we can ill afford to suffer the waste and mismanagement of tax dollars, and that, I think, will be clearly documented by these hearings. We must ensure major system procurements are on track, on budget, and meet our best estimate of projected requirements. Usually, this is not simply a simple matter of following one criterion in making an award, but you have to take into account multiple, different factors in making an award on major procurement.

Mr. Chairman, thank you for your leadership in this area. We look forward to working with you during the hearing. I look forward to hearing from the IG today. I know they have done a good job in this area, as well as many other areas.

PREPARED STATEMENT OF SENATOR NUNN

Thank you Mr. Chairman for holding this hearing on waste in the Navy procurement system. First, let me acknowledge the effort your staff has devoted to this investigation. I want to congratulate you and them for their fine work in preparation for this hearing. Our association on this Subcommittee goes back many, many years and I look forward to the continuation of that relationship.

In April of 1983, this Subcommittee met under your chairmanship to examine irregularities in Navy ship procurement. That hearing focused on cost-mischarging at a single shipyard. Today we will examine problems associated with a major ship procurement. It is with some irony that I note that the specific case study we will review today began its life-cycle not long after that 1983 hearing. The fact that we are here again is an illustration of the enormous complexity of the procurement process, the myriad factors which play a part in that process, and the requirement for adequate pre- and post-award oversight.

I understand the Staff's investigation will show that poor pre-award evaluation, improper planning, faulty construction, and poor contract oversight, led to the point where the Navy is now the owner of two, unfinished, unsalvageable, and unwanted tankers. While each of the participants will have the opportunity to provide their view of these events, it appears that there are enough problems with this procurement to share blame.

But I wish to point out that there are other factors, including Congressional action, which affected the Navy decision making process and these shipbuilders. Decisions regarding dual sourcing and the industrial mobilization base played critical roles in the original award and the subsequent transfer of the ships from Penn Ship to Tampa Shipyards. The later decision by Congress to approve a bailout for several shipyards, including Tampa, in the FY93 Department of Defense Appropriation Act, went directly against the Navy's recommendation. I spoke out against the bailout at that time. I subsequently requested an audit be conducted by the Department of Defense Inspector General to review how these bailout funds were used.

More importantly, there was a predilection during that time which favored accepting the lowest bid during the procurement process, even if it was not the best value

to the government. Decisions which resulted in any other outcome would have required extensive justification to Congress and the public. But as the investigation points out, low bid should be only one factor in determining what is the "best value" for the government. We have learned very expensive lessons from cases where it would have been more cost-effective to award contracts to companies whose bids were higher but nonetheless offered better value and more realistic timetables and costs. That is the essence of proper pre-award evaluation and as we can all readily see from this instance, hindsight is twenty-twenty.

But accepting the concept of obtaining the "best value" versus the lowest bid requires a fundamental change in attitude here in Congress and at the Department of Defense. Last October, the Senate Armed Services Committee, which I chaired at the time, in conjunction with the Committees on Governmental Affairs and Small Business, worked together to pass the Federal Acquisition Streamlining Act of 1994. Senator Roth, you played a large role in that effort through your position on the Governmental Affairs Committee along with six other Senators who are Members of this Subcommittee. This act, both directly and indirectly, addresses some of the issues raised here today. It is my hope, and certainly that of Defense Secretary Perry, that the Act will assist in making the procurement system more efficient, flexible, and accountable. It will enhance the use of "best-value" procurements. I trust that these hearings will also assist in pointing out the faults in the system so that they may be addressed and corrected.

Let me conclude by stating that I share your concern regarding the need for accountability. In our current state of declining resources, we can ill-afford to suffer the waste and mismanagement of tax dollars which will be documented by these hearings. We must ensure major system procurements are on track, on budget, and meet our best estimate of projected requirements.

I commend you again Chairman Roth, for your leadership of this Subcommittee and your staff for their work on this hearing.

Chairman ROTH. Thank you, Senator Nunn.

Senator McCain.

OPENING STATEMENT OF SENATOR McCAIN

Senator MCCAIN. Thank you, Mr. Chairman.

You and Senator Nunn have pretty well covered the issue, and I will be very brief, except to say that we all know that every taxpayer in this country has a right to be outraged by the money we wasted on two unfinished oiler ships. The Government has spent over $400 million to procure what are now two rusting hulks sitting in the James River, and a full understanding of this issue must be made for the record.

As Senator Nunn said, we should have learned a lot of these lessons long ago, but as long as errors of this magnitude are made, we must continue to correctly fulfill the role of Congress in our oversight responsibilities.

Mr. Chairman, you laid out, I think, the scenario very well. I would like to say that I think there are two very key questions here, also.

One of them is, why was the contract to finish the ships, once it was shown that Penn Ship could not accomplish that task, awarded to Tampa Shipyards when the low bidder was Avondale and Avondale had a clear record of success in completing ships of this nature? There are allegations of Congressional pressure that brought this about. There are also allegations that those ships could have been completed at Avondale instead of sent to a yard that was clearly totally unqualified to do that work.

The second question, of course, Mr. Chairman, is why in the world, as Senator Nunn has raised, why in the world we would appropriate $45 million to a shipyard over the strong disagreement of the Navy with no justification whatsoever that I know of, with-

out a Congressional hearing, without any oversight by the Senate Armed Services Committee, without a hearing in the Appropriations Committee? It appears in an appropriations bill, a $45 million bailout.

I do not think that is the way the American people expect us to do business, and I would be curious as to what factors motivated that kind of legislation over the direct and strong objection of the U.S. Navy to bail out a contractor for no good reason that I can possibly conceive.

I thank you, Mr. Chairman, and I appreciate the fact that you are holding this hearing. I think it is very important.

Chairman ROTH. Thank you, Senator McCain.

Our first witness today is no stranger to the Subcommittee. Derek Vander Schaaf is the Deputy Inspector General of the Department of Defense. I want to thank you for coming, once again. I know that your office has thoroughly investigated this contract and we are very interested in your findings.

As you know, we swear in all witnesses who appear before this Subcommittee, so please rise and raise your right hand.

Do you swear the testimony you will give before this Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. VANDER SCHAAF. I do.

Chairman ROTH. Please be seated. We look forward to your statement.

TESTIMONY OF DEREK J. VANDER SCHAAF,[1] DEPUTY INSPECTOR GENERAL, DEPARTMENT OF DEFENSE; ACCOMPANIED BY TIMOTHY J. STAEHLING, PROJECT MANAGER, OFFICE OF THE INSPECTOR GENERAL, DEPARTMENT OF DEFENSE; AND DAVID COLE, AUDITOR, DEPARTMENT OF DEFENSE

Mr. VANDER SCHAAF. Thank you. I appreciate the opportunity to be here, Mr. Chairman, and discuss problems in the Henry J. Kaiser Class T–AO 187 oiler program. These problems principally involve hulls No. 191, 192, 194, and 196, which comprised four of the 18-ship program and part of the second shipbuilding increment which the Navy refers to as a flight.

After the original contract for the four ships with Pennsylvania Shipbuilding Company was terminated for default, two of the vessels, 194 and 196, were completed by Avondale Shipyard, Incorporated, and delivered to the fleet. The other two, however, were turned over to Tampa Shipyards, Incorporated, which was unable to perform and was terminated for default.

The end result was that the Navy paid two contractors over $400 million for two oilers which were never finished to a usable state and now ride at anchor in the James River.

I cannot recall another program where two prime contractors were terminated for default on successive contracts for the same work. It is highly appropriate for the Congress to inquire into this unfortunate and wasteful matter. I hope we can, at the very least, glean some lessons from it.

[1] The prepared statement of Mr. Vander Schaaf appears in the Appendix on page 115.

One of the lessons that we have gleaned from it is the necessity of having complete contract files. The Navy shipbuilding contract management people seem to have a great deal of difficulty maintaining their files in an adequate state, where the record can be traced back over what happened. The Navy has a very good business clearance process. It is an excellent concept. Unfortunately, the controls can be badly compromised and accountability can be lost when the rationale for decisions is undocumented and contract files are negligently maintained.

The Naval Sea Systems Command has been severely criticized by various oversight organizations since the early 1980s for lack of contract records management. I have some examples of this problem in Appendix 1 of my statement.

In the case of the Kaiser Class oiler contracts that we audited, missing documents definitely hampered our ability to ascertain all of the facts and pinpoint responsibility. Hopefully, some of the missing documents or equivalent information will yet be unearthed during continued inquiries into this subject.

The first four Kaiser Class oilers were placed under contract in 1982 and 1983 to Avondale Shipyards. I will not go into all of this, but Avondale went ahead and was in the process of producing those ships and had a track record of acceptable performance.

At the same time, the Navy went ahead and solicited bids for nine additional tankers, and they had bids in the neighborhood of $1 billion, between, actually, $1 billion and $967 million from four potential bidders. The fifth proposal, which came from Pennsylvania Shipbuilding Company, was for $820 million. The Penn Ship bid was 15 percent below the next lowest offer and 17 percent below the average of the other four offerers, all of which were far more experienced in new construction than was Penn Ship.

The Navy subsequently decided to split the award, with four of the nine oilers going to Penn Ship. The best and final offer target price proposal from Penn Ship for the four oilers was $414.5 million. The proposal from Avondale, the designer and builder of the first four ships of the Kaiser Class, for the same four oilers, was $455 million, about nine percent higher.

Throughout the existence of our office, we have always preached and tried to enhance and foster competition in DoD procurement processes. We strongly endorse the benefits of moving to commercial specifications and standards whenever more stringent military requirements are not absolutely necessary.

The procurement of the second flight of Kaiser Class oilers was made under almost ideal circumstances. There was cost experience from the first flight to draw on. Competition was fierce among several potential sources. And, the ship was considered a low technical risk, due to the extensive use of commercial specifications and standards.

Nevertheless, the Navy made a series of highly questionable business decisions, starting with the May 1985 award of the contract to Penn Ship for hull Nos. 191 and 192, the target price of which was $222.5 million. They awarded options for hull Nos. 194 and 196 at about $96 million apiece. The options on these hulls were exercised in February 1986 and February 1987.

In our view, the Navy took undue risks in awarding nearly half of the second Kaiser Class flight to a technically and financially marginal contractor. The resulting fiasco became almost a parody of the problems often attributed to the alleged Government mindset that the lowest bidder is, by definition, the best supplier, or it is too much trouble to justify not awarding to the lowest bidder.

The various warning signals that were overridden by the contracting officer and, more importantly, his superiors in the Naval Sea Systems Command and the Office of the Secretary of the Navy, are discussed in our March 1994 report.

I will merely reiterate our views that the Naval Sea Systems Command cost estimating and analysis division did their jobs well, advising the decision makers that the Penn Ship proposal was significantly understated, assumed an unrealistic production learning curve, and showed overly optimistic labor hour and material estimates. There is no indication in an April 1985 business clearance memorandum that this "adverse" information was even considered. If it was considered, perhaps it was purposely not discussed in the business clearance memorandum.

The Navy did a very poor job of documenting its pre-award survey and decision making rationale, leaving reviewers several years later with understandable frustration and suspicion. During the audit, the Navy was unable to locate copies of the pre-award survey documents that are referred to in the business clearance memorandum as supporting a positive responsibility determination for Penn Ship.

To confuse matters further, the Navy claimed in a reply to a 1991 Freedom of Information Act request for the same documents that a complete pre-award survey was not considered necessary and only the financial analysis portion was done. According to Navy personnel interviewed by the auditors, the 1991 response was wrong.

Extraordinary measures taken by the Navy because of justifiable concerns about Penn Ship's finances were ineffective. First, a major public accounting firm, Peat Marwick, was hired to review the Navy's pre-award financial evaluation of Penn Ship. The public accounting firm did not take a stand against a responsibilities determination, but it did identify numerous areas of concern. During the subsequent execution of the contract, Penn Ship encountered insurmountable problems in precisely those same areas.

The Navy's response to the independent review was first to consider requiring a performance bond and later to accept a trust indenture. The performance bond approach, unfortunately, was rejected as undesirable because of the delay that it would create. During the 1980s, the DoD frequently made grievous errors because of constant pressure to accelerate acquisition programs. The trust indenture was poorly conceived and never legally perfected and filed, but the Navy accepted that worthless document anyway. No one took the initiative to ensure it was perfected and filed.

During the audit, the Navy admitted it would have received little or nothing had it attempted to collect on the trust indenture. In our view, the trust indenture was no more than window dressing, and it is hard to believe that it was ever given any credence as a way to protect the Government's interest.

Exercising the Penn Ship contract option for the fourth oiler in February 1987 was questionable and placed the Government at further risk. By that time, Penn Ship was clearly in severe financial trouble.

In August 1989, the Navy modified the Penn Ship contract, terminating it for default, canceling the trust indenture, and transferring title of a floating dock to the Navy to satisfy liabilities from Penn Ship. Hull Nos. 194 and 196 were reawarded to Avondale.

At this point, however, the Navy made another controversial and questionable choice. On grounds of industrial mobilization base considerations, the Navy awarded a contract to complete hull Nos. 191 and 192 to another financially unstable concern, Tampa Shipbuilding, Incorporated.

Hull Nos. 191 and 192 were towed from Penn Ship in Chester, Pennsylvania, to Tampa, Florida, in 1990. At that time, the Navy estimated them to be about 85 and 65 percent complete, respectively. Penn Ship, I should note, used higher figures. Tampa Shipyard was unable to execute the contract, primarily because of financial reasons. Despite several contract modifications and special funding provided by the Congress in the defense appropriation for 1993 to enable the contract ceiling price to be raised from $49 million to $166 million, progress stalled. In August 1993, the Navy terminated the Tampa contract for default. The ships were never finished, although the Navy paid Penn Ship and Tampa over $400 million.

In 1993, the Senate Armed Services Committee requested the Inspector General of DoD to provide feedback on how Tampa Shipyard and another contractor used certain "get well" funds from the FY 1993 Defense Appropriations Act. We reported back in an October 1993 report on the contract reviews of these additional funds appropriated for three Navy shipbuilding programs. We found nothing untoward in that narrowly-focused review.

Many of the ongoing DoD acquisition reform initiatives are intended to drive down costs by obtaining more competition, chiefly by using commercial practice and avoiding unduly restricted specification standards and other contract requirements.

The Kaiser Class program shows us, however, that competition is not a panacea. Government contracting officials need the authority, will, competence, and support from superiors to protect the taxpayers' interests and taking the heat for not awarding contracts to the lowest bidders that do not meet responsible financial and technical criteria. The Navy business clearance process provides a good framework for decision making, but no process is infallible.

Other work by my office related to contracts awarded to marginal contractors is summarized at Appendix 2 and shows that other DoD components have had similar problems.

Granted, we are discussing these matters with the benefit of hindsight. However, I am disturbed that the Navy response to the audit acknowledged little, if any, error.

That concludes my statement, Mr. Chairman. I will try to answer your questions.

Chairman ROTH. Thank you, Mr. Vander Schaaf. Let me make sure I understand the basic outline.

First of all, if I understand what you are saying, in essence, these were commercial ships. Conditions were ideal for going out for competitive bids. There was nothing particularly complex or difficult. These ships had been produced before and they did not differ that much from other commercial ships. So, as I said, this was an ideal situation to go out for competitive bidding?

Mr. VANDER SCHAAF. That is correct, ideal. Avondale had done the design. They had been well along in the first four ships. In fact, I think one of them was, at that point, complete. So we had a cost track record, we had a design record, and we had very good competition, because, prior to this time, the Reagan administration had made a decision to not subsidize commercial ships in the United States any longer and there was high competition in the industry to go after the remaining Navy business.

Chairman ROTH. At the same time, you conclude that the decision to award this contract to Penn Ship was marginal, at best. Why was that?

Mr. VANDER SCHAAF. A number of factors had to be considered. One, that Penn Ship had never built a ship of this size and had not built a major ship, I believe, under the Sun Ship name for nearly a decade before. They had labor rates that were higher than the existing experienced builder, Avondale. They did not have the experienced labor force that Avondale had. You put that all together, yet, they came in with a bid 15 percent below Avondale's price, which was based on costs that Avondale had just incurred. It did not make any sense to believe that the price was realistic.

Finally, the company did not have the kind of financing it needed to complete these ships if the progress payments were not enough. We paid progress at 100 percent, I should add, on this contract. If they started to incur any kind of overrun, they had no cash basis to keep this thing going.

Chairman ROTH. The fact that Penn Ship's was 15 percent below the next bid, did that not raise the question of being what people call a buy-in?

Mr. VANDER SCHAAF. Absolutely. It sure should have. It did in some elements in the Navy, clearly.

Chairman ROTH. What is a buy-in?

Mr. VANDER SCHAAF. A buy-in is when a contractor deliberately bids so low that no profit is really expected during the initial stages of a program. The contractor hopes that, while he may lose money on the first part of the program, hopefully, somehow, down the road, during the production phase, he will be able to recover from early losses and eventually emerge from the program successfully with a profit.

Chairman ROTH. The contract was ultimately terminated for default, failure to perform. A second contract was awarded to Tampa Shipyards. What was the basis of the award there? Tampa was not the low bidder, was it?

Mr. VANDER SCHAAF. No. Tampa actually had bid $6 million more to complete hull Nos. 191 and 192 than Avondale had bid, so it was not the lowest bid by any means. It was significantly higher. The basis for the award that was eventually made was that this was an industrial base consideration, and on that basis, it was critical to maintain the Tampa Shipyard in our industrial base.

Chairman ROTH. How is that decision made? Is there a procedure to go through?

Mr. VANDER SCHAAF. Not a very clear-cut procedure, no. In this case I do not know of any basis, frankly, to make that determination. From my experience, and I have had 33 years of experience in the Defense Department, I do not know of any rational basis from which one could reach that conclusion.

In fact, you could go back and look at what happened 2½, 3 years later when Tampa was terminated for default. If, in fact, that was the case 3 years earlier, you would not terminate them for default the next time around if they were really, truly critical to our national industrial base. You just would not be able to. So the logic does not hold there, Mr. Chairman.

Chairman ROTH. In other words, later, this contract was terminated for default, and you are saying that was inconsistent with the presumed finding that Tampa Shipyards was necessary for our industrial base. Is that correct?

Mr. VANDER SCHAAF. Exactly. Or, otherwise, there was a great change of heart.

Chairman ROTH. Why do you think the contract was awarded to Tampa Shipyards? What did your investigation show?

Mr. VANDER SCHAAF. I do not know if we can find a reason why it was awarded, other than the industrial base issue. That became the overriding factor. I would surmise that there were political pressures, etc., to make that award. Exactly what they were are not available in the contract files. It is not all that clear what those pressures were.

Certainly, the Navy, at this point in time, wanted to finish those ships. It would have been silly not to. We had a huge investment in those ships. Certainly, we had already spent more than we intended to for those first two ships and it was in the Government's interest to try to find a way to complete them. Why they went to Tampa, it is just sort of beyond us, other than the industrial base matter.

Chairman ROTH. When you attempted to reconstruct what happened with this contract for your report, did the Navy provide all relevant documentation that you requested?

Mr. VANDER SCHAAF. No. The Navy could not find a lot of relevant documentation. The Navy has a tendency sometimes, and I guess maybe anybody does when they are audited, but particularly the Navy, to adopt a sort of a hunker-down mentality, get into a defense squat, so to speak, and do not let the auditors get too close.

We requested documents, many of which at first could not be found. Some were later found, but many documents that we needed to complete this audit, that you would expect in a normal case to be in the business decision files, remain missing. In both cases, for the pre-award survey work and the business clearance process, you would expect certain documents to be created that simply were not in those files.

Chairman ROTH. Is it not required that a pre-award survey be made before a contract is awarded? Do the regulations not spell out with some clarity as to what that kind of survey should include?

Mr. VANDER SCHAAF. They do, sir.

Chairman ROTH. Was that survey to be found?

Mr. VANDER SCHAAF. Not in its entirety. I can ask the auditors to elaborate a little more. Basically, what we found is the final clearance letter on the Penn decision and a simple letter on the Tampa decision that said, this was for industrial base reasons this award was being made, and that was about it. A lot of the rest of the documents were not found.

Mr. STAEHLING. Yes, we found bits and pieces of the financial review, nothing related to the technical.

Mr. VANDER SCHAAF. Right. The technical aspects of this were gone.

Chairman ROTH. You are welcome to bring your people up, but they will have to be sworn to testify. That is a rule of the Subcommittee.

In other words, the documentation was not to be found. As a matter of fact, it seems that such a lack of documentation is a common problem. But it does raise the following question: Were the documents not to be found because of the lack of proper record filing, or was it a question of being destroyed, or do we know?

Mr. VANDER SCHAAF. I believe, in this case, it was as much a lack of proper record filing as anything. There is no evidence that the documents, in fact, were destroyed. The Navy, particularly the Naval Sea Systems Command, has a record of not taking care of its business this way. We found some of these documents were strewn around in filing folders that were stacked on the floor here and there, in folders placed at random, and we just had a terrible time dealing with it.

The Navy, in fact, has done its own review of this matter. I referenced that in my statement. They have agreed that they will complete another review of this documentation process here in May and provide the results to us and see if they have made any improvements.

Chairman ROTH. Let me interrupt. One of the things that concerns me is that, according to an attachment to your written statement, the lack of adequate record-keeping has been a common problem. Why do we need another study? For example, in my office, if records are not being filed, we do not need to study the situation for 12 months and then decide what to do about it. I just do not understand. Is this deliberately done?

Mr. VANDER SCHAAF. No, I do not think it is deliberately done.

Chairman ROTH. Then, why is it not done? You have the rules and regulations that a pre-award survey would be made, that as part of that survey, you find out the financial competence of the organization——

Mr. VANDER SCHAAF. The technical——

Chairman ROTH [continuing.] Its management, its facilities; is it able to do the job. This is fundamental. What worries and concerns me is that, if we make reforms and they are just ignored, there must be something wrong with the culture itself. Why have we not been able to correct this problem?

Mr. VANDER SCHAAF. I do not have an answer for you, sir. I wish I did. It is a simple matter. I do not think it is a big, complicated problem, but the Navy has to pay attention to it and get it done. Now, they have assured us they are taking one more look at this and they are going to have their contract files in order.

I have a contract audit follow-up organization in our office that goes around and tries to make sure that buying activities take appropriate actions in response to contract audits from the Defense Contract Audit Agency, and we used to frequently find that these organizations either had not received the contract audit report or had not acted properly on it to recover the Government funds and documented their decisions. We wrote them up repeatedly. Hopefully, the constant pratice of doing this is improving the overall process, and I think it is. Some buying centers have made tremendous progress in this area.

Others have not been as good. As for the Naval Sea Systems Command, I do not know exactly what their present state is. I can tell you, from now on, every single major audit that involves weapons procured by NAVSEA will, in fact, check the records management aspect. It seems rather routine, but we have to go in and do it.

Chairman ROTH. But if I understand you, Mr. Vander Schaaf, you are saying that in neither of these contracts do we have the documentation that is required by regulations and should enable us to understand why these contracts were awarded as they were, is that correct?

Mr. VANDER SCHAAF. That is correct, particularly the Penn Ship one. You do not need as much on the Tampa one because they simply treated that as an industrial base issue and to what degree they actually looked at the labor force and the technical capability and the past performance history, etc., is unclear. I think they just did not look at it. They just made the decision that this was an industrial base-related award and went ahead with it.

Chairman ROTH. Are you saying that if you declare a company to be necessary as part of our industrial base, that is all you have to say? Do they not have to document why it is needed?

Mr. VANDER SCHAAF. I am not exactly sure what all the regulatory requirements are in that particular matter, but that would tend to override the necessity to do some of these other specific items with respect to that specific contract.

Chairman ROTH. The current investigation as to record keeping has been going on for how long?

Mr. VANDER SCHAAF. I do not know. They agreed, in response to the audit, to undertake it, and the Navy was late in starting its review. They have now promised that, by the end of May, they will have re-reviewed contract files in the Naval Sea Systems Command and give us a report on the status of the situation. I will pass that on to the Subcommittee just as soon as I can. I will go take another look with our auditors, if necessary.

Chairman ROTH. More importantly, I would like to know what is done about it, if there is any follow through.

Mr. VANDER SCHAAF. Hopefully, there are some Navy people here that are getting the message.

Chairman ROTH. Going back, as you said, in your judgment, or the judgment of the IG, the Navy took undue risk in awarding the contract to Penn Ship, that it took undue risk in awarding the contract to what you call a technically, I believe, financially-marginal contractor. Did Penn Ship have the financial resources necessary to complete this contract?

Mr. VANDER SCHAAF. Not from our viewpoint, no, sir.

Chairman ROTH. Did it have the management expertise and labor force to perform the contract?

Mr. VANDER SCHAAF. The Delaware River Valley labor force for shipbuilding had largely dissipated over the past decade. My understanding is, in order to complete this contract, they had to bring in labor from elsewhere around the country to get it done.

There is some debate, I guess, about the degree of experience of the current owners of what was Sun Ship which then became Penn Ship. They had some experience, I guess, in maintenance and building of smaller craft in Texas, but they were basically real estate entrepreneurs, as we understood it from the documents we looked at and their past history. They were not shipbuilders——

Chairman ROTH. They had built no ships?

Mr. VANDER SCHAAF. I could not say that they had built no ships. I cannot speak with authority on that. They had not built a ship of this size or type before.

Chairman ROTH. But, again, this ship was not a complex undertaking.

Mr. VANDER SCHAAF. It was not a complex ship. You still have to have financing to ride you over some problems, etc., and they were not in a position to have that. They could not afford, particularly when you looked at a buy-in situation, to take a major loss and get well down-line. The financing just was not there.

Chairman ROTH. In view of its record of nonperformance, why did the Navy award options for the third and fourth ships to Penn Ship?

Mr. VANDER SCHAAF. I think they did that for two reasons, sir. One, they knew they were in trouble on the first and second ships, big trouble, and they sent good money after bad money by simply hoping that this would provide an additional cash infusion into Penn Ship. Penn Ship now has another contract in its hands. It now can go to financial institutions in a better position to borrow money.

Second, what it did is it allowed them to allocate their overhead against a bigger direct base. They could now allocate overhead against four ships instead of two, and this would supposedly also help the financial situation. Of course, the decision backfired.

Chairman ROTH. Didn't the Navy, in effect, expand its own exposure?

Mr. VANDER SCHAAF. Absolutely. Our reading of the facts, again, we are playing Monday-morning quarterback to some degree, indicates it was definitely clear by February 1987, when the Navy awarded the second option ship, the fourth ship. It was less clear but even advisable in February 1986, that the Navy should have terminated the contract. But, instead, they went ahead and threw more money at it.

Chairman ROTH. Let me ask you this. Can we name the individual who was responsible for awarding the contract to Penn Ship? Can we name the individual who was responsible for exercising the options?

Mr. VANDER SCHAAF. Yes, I think we can name the individuals, in the sense of the contracting officers involved, but I would be very reluctant to name them as the responsible parties in this busi-

ness. These kinds of decisions are not made by the contracting officer who may put his or her name on the bottom of that contract. These decisions were made at higher levels within the Navy, very, very definitely.

Chairman ROTH. Are you saying, then, this was a collective decision? There is no one person to hold accountable?

Mr. VANDER SCHAAF. That is correct.

Chairman ROTH. How do you judge performance, then, collective decisions? How do you have accountability?

Mr. VANDER SCHAAF. I think you have to hold the institution, to some degree, accountable here, and I guess that is not the answer you are looking for, Senator, in that sense. I do not know of any way to hold one individual accountable.

In the particular cases, I would have to say the Assistant Secretary of the Navy for Shipbuilding and Logistics at that time should probably be held as accountable as anyone for these decisions. Both the management philosophy that was applied at that time and the dual sourcing philosophy, which we found in a lot of other cases, which has not worked, there was firm fixed-price contracting. It was a go-go period of time in the defense business, and a lot of it just did not work.

Chairman ROTH. There was a trust indenture. Why was that required?

Mr. VANDER SCHAAF. Because it was evident from the pre-award work that had been done, basically, in the financial area, that there was a good degree of likelihood that the contractor could not perform. They considered going to performance bonds under the Miller Act and decided that performance bonds would be too complex and, in fact, they would have to go back and have all the potential contractors, all five potential contractors, come forward with a performance bond, etc. It would delay the whole process.

In response to that, Penn Ship, I should say, not the Navy, came up with the idea of this trust indenture. Penn Ship selected Fidelity Bank to be the Navy's trustee for this matter, not the Navy. It went ahead on that basis.

Chairman ROTH. As I understand it, a trust indenture was drafted by the lawyers of Penn Ship, is that correct?

Mr. VANDER SCHAAF. That is correct.

Chairman ROTH. And it was Penn Ship that selected Fidelity as the trustee?

Mr. VANDER SCHAAF. That is correct.

Chairman ROTH. And Fidelity was also the bank for Penn Ship?

Mr. VANDER SCHAAF. I do not know if they were the only bank for Penn Ship, but they had certainly done business and were doing business with Penn Ship. Penn Ship had a line of credit with that bank and that bank held liens on certain Penn Ship assets at the same time.

Chairman ROTH. Isn't that a conflict of interest?

Mr. VANDER SCHAAF. In my opinion, yes, sir. I do not know how a bank can build fire walls to prevent that, because the bank, at that point, should have had the Navy's interest, as the trustee for the Navy, at heart, not the interest of the shipbuilder. Since the shipbuilder owed them money, it seems to me they were conflicted.

Chairman ROTH. What was the Navy's role? Who was responsible for the trust indenture from the Navy standpoint?

Mr. VANDER SCHAAF. I think the Navy saw this as an opportunity to make the program go, to do the dual sourcing effectively and get the ships as quickly as possible.

Let me go back just a little bit, Mr. Chairman. You have to understand the environment at this time. Elements in the Defense Department were pushing for a 600-ship Navy, a very tough thing to do. They were looking to grow the Navy to 600 ships. They were also attempting to gain support for that by going to a new home porting process and spending a lot of money on home porting, which also ended up as justification for bad investments.

I see this as part of a philosophy of, well, let us spread the Navy's business around. Let us gain a lot of political support for what we are doing here and go forth with it. You have to understand the environment at the time.

Chairman ROTH. Let me go back. I understand the aggressiveness of the moment. At the same time, as I understand it, the Secretary of the Navy raised the question of a performance bond. Then, for the reasons you have described, that it complicated the procurement, they decided not to go that direction and Penn Ship came up with the concept of a trust indenture. Navy went along.

But even in its aggressiveness to get the job done, shouldn't the Navy have ensured that the trust indenture was properly drafted and properly filed? It is my understanding that it was not filed so that it was a nullity, for all practical purposes. Is that not correct?

Mr. VANDER SCHAAF. It turned out to be that. It turned out to be the truth, yes, sir. When the thing was terminated, then they found out that the trust indenture had not been filed and perfected and——

Chairman ROTH. Who should normally, in the Navy, in this kind of procurement, review the security agreement to ensure that it is valid?

Mr. VANDER SCHAAF. Through the award. I would think the General Counsel of the Naval Sea Systems Command should have taken steps to ensure that that document was filed and perfected.

Chairman ROTH. We are not talking peanuts here, as I understand it. What kind of assets were involved?

Mr. VANDER SCHAAF. Potential assets that were involved were some real estate assets. There was a crane or derrick that was mounted on a barge, a floating crane. You had a drydock.

Chairman ROTH. Do you have any estimate what the value of these assets were, the land and so forth?

Mr. VANDER SCHAAF. Sir, I believe the value we looked at, it was $69 million that was potentially available. They had done some market asset reviews prior to the award and Penn Ship appeared to have $69.4 million in assets. I guess this was in assets at one point in time when they started this program.

Chairman ROTH. How much was that, again?

Mr. VANDER SCHAAF. Sixty-nine-point-four million.

Chairman ROTH. That is not exactly peanuts, as I said.

Mr. VANDER SCHAAF. No, no, not exactly at all, sir.

Senator McCain. Mr. Chairman, may I ask, are you going to ask questions until the vote? If so, I will leave. Could you give me some idea as to how we will do the questioning?

Chairman Roth. Yes. We do intend to continue this line.

Senator McCain. Thank you, Mr. Chairman.

Chairman Roth. Did any of Fidelity Bank's loans ever result in Fidelity having a second position ahead of the Navy?

Mr. Vander Schaaf. Fidelity held the first position. At least, the Navy saw its position as being a covered creditor, but in a second position. That is the way, I guess, I would describe it.

Chairman Roth. At the time of termination, what money was owed by Penn Ship to the Navy?

Mr. Vander Schaaf. It is not clear. We did not audit that piece. We looked at the award. I cannot give you an exact number. If you would have had strict enforcement of the basic contract, etc., it would be in the neighborhood of $100 million or over, probably. However, the Navy agreed to settle out with Penn Ship when they terminated for, I believe, $24 million.

Chairman Roth. Let me ask you, why was the Navy willing to settle for $24 million when, potentially, the amount of actual damages could have approached $100 million?

Mr. Vander Schaaf. I think that either the trustees or the representatives of Penn Ship convinced Navy management that there really weren't assets available to cover all liability. When you terminate for default, you go through a process of allocating all the resources and trying to recover the resources for the unliquidated progress payments and so forth. If we had gone through that whole process, as I say, we probably would have charged Penn Ship with something in the neighborhood of $100 million.

I believe that Penn Ship was effective in getting the Navy to believe that there simply were not assets there to recover and, therefore, they simply made an agreement to walk away from this deal with $24 million, for which the Navy took the floating drydock as representing $19 million of the $24 million. In your opening statement you discussed the drydock, and as far as I know, your figures and your information were correct.

They still owed the Navy another $5 million. There was an opportunity to obtain that, we have determined, but the Navy never made a serious effort to recover that $5 million.

Chairman Roth. So, in essence, all the Navy received was a drydock?

Mr. Vander Schaaf. Yes. And as you explained in your statement, that drydock has never been used by the Navy. It has been leased out. It is not leased out for Navy work. I believe the lessee pays $450,000 a year for lease costs to the Navy, but the lease costs are offset by any expenses that the drydock lessee incurs in maintaining the drydock to keep it safe. The lessee has already incurred over $4.5 million worth of expenses. The lessee has taken a 10-year lease at $450,000 per year. So, for the 10-year period, the lessee is not going to pay the Navy anything for leasing the drydock. In effect, the Navy has nothing.

Chairman Roth. At termination, when Penn Ship owed millions of dollars to the Navy, Penn Ship was paid to provide security for

the ships and materials that belonged to the Navy. What were the details of that arrangement?

Mr. VANDER SCHAAF. The details were that Penn Ship was to receive $45,000 a day for keeping these two ships secure, and they got $90,000 a day on weekends or something. I am not exactly sure what the total amount of money involved here came to. I believe it was $4.6 million, in that neighborhood, anyway, that they got for doing that. They got some other incidentals.

Effectively, what I think was happening is that the Navy was paying the holding costs to keep the shipyard "available" for a longer period of time, even though the Navy no longer had any work in the yard, and I am not sure if there was any other significant commercial work in the yard or not. I do not have any idea. So we spent another $4.6 million to secure the ships. Well, at that point, we still had a good investment. We had to secure it in some sense of the word, but I question whether you have to pay the carrying charges on an entire shipyard to secure two ships, one still in drydock, I believe, and one out at anchor in the Chester River. It seems awfully high.

Chairman ROTH. So the contract was terminated for default and the Navy then went to Tampa Shipyards on the basis of industrial policy. There is practically no documentation as to why?

Mr. VANDER SCHAAF. I do not think there is. I am not 100 percent up on that. I will put something in your record if there is more there, but as far as I know, it was pretty much a decision by fiat, the industrial base and that is it.

[The information follows:]

We have the correspondence provided by the Committee and have the following observations:

On November 16, 1989, the Office of the Assistant Secretary of the Navy (Shipbuilding and Logistics), authorized the Naval Sea Systems Command to award the Kaiser Class oilers reprocurement contract to Tampa Shipyards, Incorporated, without providing for full and open competition. The Navy decision was based on maintaining the national industrial mobilization base for underway replenishment ships. The Navy approval rationale apparently was based on developments occurring after the Secretary of the Navy issued an analysis on shipyard capacity related to the Kaiser Class oilers in December 1988. That analysis had concluded the closure of Tampa Shipyards would have a minimal impact on the shortfall of new auxiliary ship construction capacity.

The December 1988 analysis considered National Steel and Shipbuilding Company (NASSCO) a solid competitor for the Navy 1990 program objective memorandum (POM) ship requirements. However, NASSCO circumstances changed significantly after December 1988. At the time the analysis was performed, NASSCO was a wholly owned subsidiary of Morrison Knudsen Company, an engineering and construction conglomerate. However, as of April 1989, NASSCO became an independent company owned by the company's employees through an employee stock option plan. As a result of the change in ownership, NASSCO no longer had the financial support of the Morrison Knudsen Company. The Navy concluded that "NASSCO must both increase productivity and obtain new work or its viability as a competitor will be in jeopardy within two years." the Navy further concluded that if NASSCO ceased as a viable competitor, Avondale Industries, Incorporated (Avondale), would effectively be the sole remaining source for large auxiliary ships. The Navy concluded that "Therefore, the industrial base for large auxiliary ship construction is not secure."

A development not considered in the December 1988 analysis was the potential appropriation of funds for ship construction exceeding the program laid out in the 1990 POM. The House Appropriation Committee Report on DoD appropriations for FY 1990 proposed a fast sealift program. The Navy concluded that, if the fast sealift program was enacted, it would create more auxiliary and amphibious ship require-

ments than could be accommodated by the combined capabilities of NASSCO and Avondale.

The Navy concluded that it was in the interest of national defense to maintain Tampa Shipyards as a viable competitor for POM 1990 and fast sealift program requirements. The Navy therefore awarded the reprocurement contract to complete the construction of two oilers to Tampa Shipyards for $49 million.

On November 24, 1989, Avondale Industries, Incorporated, protested the Tampa Shipyards contract award to the Comptroller General for the United States. The basis for Avondale's protest was that the Navy improperly awarded a sole-source contract justified on the industrial mobilization base after requesting quotations from other firms to perform the reprocurement contract. Avondale alleged that the Navy industrial mobilization decision was not based on substantial and accurate facts, and that the Navy abused its discretion in awarding the contract to Tampa Shipyards.

The Comptroller General concluded, in reviewing the Navy's justification for award to Tampa Shipyards, that the factors considered by the Navy in fact existed at the time of award. The Comptroller General concluded there was nothing improper in the Navy concluding that the loss of Morrison Knudsen Company's financial support cast doubt on NASSCO viability as an auxiliary ship competitor in the long term. Further, the Comptroller General concluded "the fact that the Navy later chose to recommend the Fast Sealift Program for deferral does not change the fact that at the time the justification and approval was executed, it was likely that congress would authorize and fund the program." The Comptroller General also concluded "the Navy reasonably believed the program would place a burden on the shipbuilding industrial base and potentially create enough work to require an additional shipbuilder." On March 22, 1990, the Comptroller General denied Avondale's protest.

It is unclear when the Navy realized that auxiliary ship requirements had again changed and the two incomplete oilers were no longer required. They were not officially declared excess until November 1994.

Chairman ROTH. There is no evidence as to what thinking went into that decision?

Mr. VANDER SCHAAF. As a matter of fact, we will go check the record on this for you. I believe Avondale protested that award to the General Accounting Office and the General Accounting Office held that, so long as the Navy made a determination that this was an industrial base consideration, then that was the driving factor in the award. Avondale's $6 million lower bid and its clear ability to build the ships were overtaken by the industrial base factor.

Chairman ROTH. Are you aware of any vital need for the Tampa Shipyards as part of the industrial base?

Mr. VANDER SCHAAF. No, sir. We did not audit that, but, personally, I am not aware of any particular unique need or capability that Tampa has that we do not have elsewhere. I do not know what it would be.

Chairman ROTH. Tampa Shipyards requested an emergency bailout of $25 million, is that correct?

Mr. VANDER SCHAAF. That is correct. At one point, they did. The Navy refused to provided it.

Chairman ROTH. What was the basis for that request?

Mr. VANDER SCHAAF. They were in financial trouble. They could not meet the original contract price and so they were in trouble. It was clear that they were going to overshoot the $49 million contract ceiling price. Therefore, they wanted the Navy to send money.

Chairman ROTH. Was there any indication the $25 million would save the situation?

Mr. VANDER SCHAAF. At that point, they probably felt it would save the situation, although they——

Chairman ROTH. Who do you mean by "they"?

Mr. VANDER SCHAAF. The Tampa Shipbuilding people. You would have to ask the supervisor of shipbuilding that was on the facility at that point. I think he would have the best estimate of what that need was. It certainly would have gotten the Navy into the business to a higher degree and put more Naval funds at risk. Whether or not it would ever be successful, I do not know. I guess if you spend enough money for a long enough period of time on a given program, you can make it work anyway. But it clearly was starting to get out of hand here.

Chairman ROTH. I have asked questions for quite a few minutes. Senator Nunn, would you like to inquire?

Senator NUNN. Thank you, Mr. Chairman. I know we have votes coming up. Let me just ask a few.

Mr. Vander Schaaf, you state in your summary that, "Government contracting officials need the authority, the will, the competence, and support from superiors to protect the taxpayers' interest by taking the heat for not awarding contracts to the lowest bidder that cannot meet reasonable financial and technical criteria."

To your knowledge, has the Navy or other services taken steps to offer such support or given directives to contracting officers saying, if the low bid is not going to be capable of performing the job, then do not go with the low bid?

Mr. VANDER SCHAAF. I do not know if they have given specific directions, but, clearly, the acquisition reform movement of the last couple of years has placed some additional emphasis on going with known performing contractors, contractors with track records and histories that indicate they can produce and so forth.

So there has been a clear down-playing in the Department of lowest price and more emphasis on best value. Exactly how that was spread in various buying commands, I could not tell you, whether it is by letter, directive, etc., but the word is out that we are looking for value, not necessarily for low price.

Senator NUNN. If you are a newly-emerging company and you believe you have the competence and you put in the low bid, what is it you can do to make sure the Government gets delivery? Do we not have performance bonds that assure the Government that things will be done?

Mr. VANDER SCHAAF. Yes, we do, and that is what we do in almost all of our construction contracts under the Miller Act, yes.

Senator NUNN. What was done in this case?

Mr. VANDER SCHAAF. The Navy used a trust indenture as some sort of a unique approach that would have, hopefully, if properly filed and properly perfected and so forth and so on, would have given the Navy some degree of protection, but it turned out it wasn't treated appropriately. This idea was developed by the Penn Ship people as a way of avoiding the delays that going to a performance bond would have caused in the awarding of the contract.

Senator NUNN. Now, this trust indenture, was that in the nature of a bond, a guaranteed performance?

Mr. VANDER SCHAAF. No.

Senator NUNN. What is a trust indenture?

Mr. VANDER SCHAAF. The way I understand the trust indenture here is that certain assets were pledged to the Navy if, in fact, the contract had to be terminated for default. The trustee would hold

those assets and protect the Navy's interest. The trustee in this case was a bank, and you were not here when Senator Roth got into this, but it was a Philadelphia bank, Fidelity Bank, I believe, that——

Senator NUNN. I do not want to retrace the old steps again.

Mr. VANDER SCHAAF. No, I do not either, but——

Senator NUNN. But what went wrong with that? Was there not adequate security, or was it not a proper legal document, or what was it?

Mr. VANDER SCHAAF. Two things. There was not adequate security. There was not enough there. There were other previous lienholders on most of that property that was in the trust. Second, it was not properly filed with the courts and etc., that it had to be filed with.

Senator NUNN. Whose fault was that?

Mr. VANDER SCHAAF. I guess the trustee's fault, primarily. However, the Navy should have checked to make sure its interest was protected.

Senator NUNN. Did the Navy have lawyers working on this?

Mr. VANDER SCHAAF. Certainly. I would hope so. As I mentioned, the lawyers from the Naval Sea Systems Command should have looked at that right away, as soon as that contract was awarded, to make sure that trust was properly taken care of as part of the package.

Senator NUNN. Did they look at it?

Mr. VANDER SCHAAF. I do not know.

Chairman ROTH. Let me point out to my distinguished colleague, first of all, Fidelity Bank, the trustee also did business with Penn Ship, so it appears to me there was a conflict of interest.

As far as we can determine, no review of the document was made. They failed to file it, as required, so——

Senator NUNN. What do you mean, no legal review? No legal review was made?

Mr. VANDER SCHAAF. I believe, Senator, there was a legal review made. We had a hard time getting documentation. We first tried to get the trust indenture document from Fidelity Bank. They refused to provide the trust indenture to us. We eventually were about to subpoena the document, and——

Senator NUNN. The Navy did not have a copy?

Mr. VANDER SCHAAF. It took a while to find one in the Navy. It was not like, here it is, IG auditors. It was like——

Mr. STAEHLING. It took a long time to get it.

Mr. VANDER SCHAAF. First, we could not find it or whatever. It was the same thing, and then, eventually, we got a copy of it.

Senator NUNN. It does not seem to me a very clear pattern of accountability as to how that went wrong. Financial assets usually have appraisals. Title checks on property put up for security are routine matters in the everyday commercial world. You would never take security in the commercial world without having a title check, knowing whether there were previously-filed liens or whether the security was free and clear. It seems to me there is a real botch job here on the legal part of it.

Mr. VANDER SCHAAF. There is some question about that. Either our office or the Naval Investigative Service needs to take a more

detailed look at the arrangements between the bank and the Pennsylvania Shipbuilding Company. That stuff is getting old now and the statute of limitations is running, Senator, but it has to be looked at.

Senator NUNN. In October of 1993, your agency provided an audit that I requested regarding how Tampa Shipyard had used a $45 million bailout provision, including the Fiscal Year 1993 Defense Appropriation Act for the oiler contract, and there were other similar matters that didn't relate to this contract that you also looked at, is that not correct?

Mr. VANDER SCHAAF. That is correct. There were three others—two others.

Senator NUNN. Could you describe how the money was used, that $45 million was used?

Mr. VANDER SCHAAF. Certainly. The $45 million was appropriated. Immediately upon appropriation, the Navy raised the ceiling price on the two ships that were now in the Tampa Shipyard by $45 million. The Navy wrote a check within a matter of 30 days or so for $6 million, I believe. I can get you the exact dates here, if you want to get into it. It was a check of $6 million, followed up about 2 weeks later with another check for $6.1 million. The two together added to $12.2 million.

What we had hoped, or, I guess, what the Navy had hoped would result from this is that additional labor would be purchased, additional material or whatever additional costs that the yard was incurring, they would go into the ships. What happened with this first money right away is that the entrepreneur involved took back his investment. The company paid its loans to the bank that were backed up by Mr. Steinbrenner, whose credit was at risk with the bank and who had also made a loan to the company, and those were paid off immediately.

So the first $10 million of the $12 million, actually did not do anything directly for the shipbuilding program. It only took the risk and transferred the risk from the owners of the shipyard to the Navy. That is effectively what you did with the first $10 million.

Senator NUNN. The Navy had no understanding on that when they provided the money?

Mr. VANDER SCHAAF. Apparently not. If they had known, they just——

Senator NUNN. They just wrote a check?

Mr. VANDER SCHAAF. They wrote the checks and sent them down there. They did not make an agreement that this money would go into those ships. It effectively did not add any more capital to the production of ships.

Senator NUNN. Was that in accordance with the appropriation act? Did the appropriation act have any kind of——

Mr. VANDER SCHAAF. My understanding is the appropriation act did not spell out specific requirements.

Senator NUNN. It was up to the Navy? It left it up to the Navy?

Mr. VANDER SCHAAF. That was up to the Navy.

Senator NUNN. Now, you said nothing——

Mr. VANDER SCHAAF. I did not get finished with the whole $45 million. Then, over a period of another several months, another $6

million was paid, approximately, which brought the total of additional progress payments to $18.1 million. At that point, the Navy terminated the contract for default and the rest of the $45 million was never expended against these two ships.

Senator NUNN. How much of the $45 million was ever spent?

Mr. VANDER SCHAAF. Eighteen-point-one million dollars was provided to Tampa Shipbuilding, except that those funds did not really come out of the 1993 appropriations. At least, all of it did not come out. That is my understanding. Some of it came by reprogramming previous year funds that the Navy had available in its shipbuilding account that used that money. Then, later on, in the Fiscal Year 1994 Defense Appropriations Act, much of the money that was added for the two ships was reprogrammed again to other Naval ships that had cost increases.

Senator NUNN. When you said in your conclusion that, I think you said, "nothing untoward" was found in that, what do you mean by "nothing untoward"?

Mr. VANDER SCHAAF. All I am saying is nothing illegal. I guess I should put it that way. Clearly, after I got more familiar with this process of what happened, again, I became more concerned that at least the Navy should have taken steps to ensure that this additional money went into the ships and did not allow the investors in the shipyard to effectively trade the risk and place the risk back on the Navy and pull their money out of this deal.

Senator NUNN. Mr. Chairman, I know we have a vote on. Let me ask one other question. The Navy contracted with a major public accounting firm to perform an independent review of Penn Ship. What is the value of these kind of so-called independent accounting reviews? How much did this help in this? This was a Peat Marwick review.

Mr. VANDER SCHAAF. I think this could have helped. The Navy, Senator, uses these firms a little more often. It is not routine, by any means, but the Navy uses these firms far more often than the Army or the Air Force.

In this case, the Peat Marwick auditors looked at the financial aspects only. They raised some very good questions, but they never drew the final line that, I think, was appropriate. Had auditors from the Defense Contract Audit Agency or the Office of Inspector General been involved, and I can sit here and sort of say this after the fact, hopefully we would have said, this is not a good deal. This does not make good business sense.

They never reached that point where they said this is too risky, this is high-risk business, even though they pointed out a lot of the risks to the Navy.

Senator NUNN. One final question. In this appropriation act that passed the Congress, it says, "Notwithstanding any other provision of law," and so forth, about the $5 million. It then goes on, "Such increase shall be made upon the contractor's execution of a full and final release, discharging the Government, its officers, agents, and employees from any liability or activities under associated with T–AO 191 and 192 contracts," and so forth and so on. Was that release obtained as this money was disbursed?

Mr. VANDER SCHAAF. Yes, it was. I am told it was. But that release does not help this problem I talked about——

Senator NUNN. No.

Mr. VANDER SCHAAF [continuing.] About bringing additional funds into the ships, as opposed to reducing the shipyard's risk.

Senator NUNN. But there was no requirement whatsoever, either by the Congressional act or by the Navy itself, as to what would happen to these funds when they were turned over? They could be spent any way they wanted to be spent, as far as you know? As far as your audit determined, that money could have been spent any way the company decided to?

Mr. VANDER SCHAAF. Yes, Senator.

Senator NUNN. And still have been legal?

Mr. VANDER SCHAAF. Any way on those two ships, and they were spent on those two ships, in that sense of the word, but the first $10 million did not do the ship program itself much good. It did the risk holders, the investors in Tampa Ship a lot of good.

Senator NUNN. When you said "nothing untoward", I assume you would now want to make that a very narrow definition of what you mean by nothing untoward. You mean that there was no breach of the law?

Mr. VANDER SCHAAF. That is right.

Senator NUNN. You are not saying that the money was either effectively or efficiently spent?

Mr. VANDER SCHAAF. Exactly. I would not say it was efficiently spent. If you are going to go forward with those two ships, then you should have put the money on that. You should not allow the investors to recover their money.

Senator NUNN. Would you, then, say it was ineffectively and inefficiently spent?

Mr. VANDER SCHAAF. At least, the first $10 million, and they only went up to $18 million and then the program was terminated. The whole $45 million never got spent.

Senator NUNN. Thank you, Mr. Chairman.

Chairman ROTH. We have begun a series of votes. We are not exactly certain how many, but we will be in recess until 1 p.m..

[Recess.]

Chairman ROTH. Mr. Vander Schaaf, would you please return to the witness table? I have two or three questions I want to ask, and then I know Senator McCain will return and he has some questions he would like to ask you.

I know you generally addressed this issue this morning, but just so I understand, is there an explanation for the obvious discrepancy between Tampa Shipyards, on the one hand, being classified as necessary to our industrial base when awarded the contract, and then, less than 3 years later, not being considered necessary to the national defense when denied the bailout?

Mr. VANDER SCHAAF. I can probably expand a little bit on that, but I cannot do much more than I did this morning. I think the Navy felt that we were heading in the direction of 600 ships—I guess they had given up pretty much at this time on that number, but they saw the possibility that there would be some fast sealift ships or some other military sealift command-type vessels that would need to be produced later on that, somehow, if they kept Tampa Ship alive, that Tampa would eventually add competition or could build those ships.

I think that was sort of unrealistic from the start. Clearly, Tampa did not offer the Nation any industrial capacity or any unique capacity or capability that we did not already have elsewhere.

So I do not think the initial determination that this was critical to our national shipbuilding industrial base was a logical decision, and that became evident, then, when they were unwilling to invest an additional $25 million, as Tampa Shipbuilding required right away, and then, later on, the Congress appropriated the $45 million, not all of which was paid, against the contract.

That is about all I can do to enlighten you on that. I understand that there was some sort of Secretary of the Navy review with respect to this industrial base question. I will attempt to get a copy of that for the Subcommittee and provide that with our comments to it and see if that sheds some more light on this part of the problem.

Chairman ROTH. Certainly, on the surface, it does not make any sense.

Mr. VANDER SCHAAF. It does not make sense, sir. I agree with you.

Chairman ROTH. The original contract was awarded to Tampa Shipyards for $49 million. How much did Tampa receive under this contract before being terminated for default?

Mr. VANDER SCHAAF. They received $102 million, in round numbers. I do not have the exact number here in front of me.

Chairman ROTH. What did the Government receive?

Mr. VANDER SCHAAF. The Government did not receive anything. We still had two incomplete ships. I guess we got another bill to tow them back up to the James River and park them, but other than that, I do not know if we got anything. I cannot imagine what the Government got out of that.

Chairman ROTH. In my opening statement, I made the comment about the importance of accountability in the process. I would like to ask you once more, as a result of the $450 million fiasco, has anyone in the Navy been held personally accountable?

Mr. VANDER SCHAAF. Not to the best of my knowledge, sir. I have a list of names of people who were in various positions, and I go all the way from the contracting officers to the program office people in Program Office 383, which was the responsible office for this, on up the line. I certainly would be very reluctant to hold career people at NAVSEA who did the contracting, who did the program management for this program responsible, without taking into account the role of the Office of the Secretary of the Navy.

In many cases, I think these people have left the Navy, particularly the more senior officials further up the line, the Assistant Secretary of the Navy for Research, Engineering, and Systems, and so forth.

Chairman ROTH. Go ahead.

Mr. VANDER SCHAAF. And the Assistant Secretary for Shipbuilding and Logistics. Those two offices sort of changed names during this period.

Chairman ROTH. What concerns me is that I do not think any change we make in the rules and regulations are going to have any effect until someone somewhere is held accountable. It seems to me

that is basic to what these hearings are bringing out and to what we have found in the past. I think the——

Mr. VANDER SCHAAF. I agree. I certainly cannot argue with that. It is unfortunate, in some ways. There is a lot of turnover in Government. People come and go, particularly at the higher levels, and that leads to these kinds of problems. You just do not hold people accountable.

Chairman ROTH. Senator McCain, I apologize for the lateness, but appreciate your being here.

Senator MCCAIN. Thank you, Mr. Chairman.

I just want to follow up again. Mr. Vander Schaaf, I think one of your jobs is—and, by the way, I think you have done an outstanding job for many years, but one of your jobs is to tell Congress who is responsible.

Mr. VANDER SCHAAF. I recognize that.

Senator MCCAIN. Well, then why can't you?

Mr. VANDER SCHAAF. First of all, we got into this too late. Second, we do——

Senator MCCAIN. Do you know who was working on the job at the time?

Mr. VANDER SCHAAF. Yes. I do not know everybody who was working on the job. We can get you some names of who was working on the job at various times. I can tell you who was the head of Program Office 383 at those periods of time. I can tell you who the contracting officers were. I can tell you that sort of thing.

Senator MCCAIN. Maybe you can supply us——

Mr. VANDER SCHAAF. Sir, we do hold people accountable more often, maybe, than you recognize. We do convict people, and our record with respect to convictions and indictments and so forth is fairly strong and substantial.

In this case, I do not know where we would go with that. I am not convinced there is a criminal kind of case here. There is certainly some very poor management here.

Senator MCCAIN. Mr. Vander Schaaf, I think there is a difference between convictions and indictments, which, again, you have an admirable record, and people who are given positions of responsibility, many times approved by the U.S. Senate. They live pretty good lifestyles, not a bad life. In fact, there is great competition for some of these jobs. They are placed in positions of responsibility, and somebody was responsible for some of these decisions that were made. It is up to us, as public servants, to account to the people of our State who did it.

For you to sit there and say, "No one person is accountable," and then to respond to Senator Roth, "no one that we can point out is responsible and accountable," there is something wrong, I have to tell you, and there is something wrong with the way you are doing your job if you cannot tell this Congress who was in charge when these things happened and why they happened.

Mr. VANDER SCHAAF. I will put into the record a list of names of who was in charge, but I will not connect myself with saying that one individual is absolutely responsible. I have some ideas, but absent my ability to prove it, sir, I am not coming before this Subcommittee and putting a cloud over people's heads until I have some darn good evidence that they did some things—either de-

stroyed documents or put money in their pockets to get things done, and I do not have any kind of evidence along that line.

[The information follows:]

The Department of the Navy officials responsible for Kaiser Class Oiler contracts with Pennsylvania Shipbuilding Company and Tampa Shipyards, Incorporated, included the following:

Secretary of the Navy
- February 1981-April 1987—John Lehman
- April 1987-February 1988—James Webb
- March 1988-May 1989—William Ball
- June 1989-July 1992—H. Lawrence Garrett III
- August 1992-January 1993—Sean O'Keefe
- July 1993-Present—John H. Dalton

Assistant Secretary of the Navy (Shipbuilding & Logistics)
- 1985-March 1990—Everett Pyatt

Assistant Secretary of the Navy (Research, Development and Acquisition)
- March 1990-January 1993—Gerald Cann
- January 1993-October 1993—Gerald Witman (acting)
- October 1993-Present—Nora Slatkin

NAVSEA Commander
- March 1980-June 1985—VADM Earl B. Fowler
- June 1985-September 1988—VADM William H. Rowden
- September 1988-June 1991—VADM Peter M. Heckman
- June 1991-April 1994—VADM Kenneth C. Malley
- April 1994-Present—VADM George R. Sterner

NAVSEA Deputy Commander for Contracts
- August 1983-August 1988—RADM William Hauenstein
- September 1988-March 1993—RADM Eugene Harshbarger
- March 1993-May 1994—RADM Mike Sullivan
- May 1994-Present—Captain Richard Gimnam

NAVSEA Assistant Deputy Commander for Contracts
- October 1979-February 1985—Grey Cammack
- February 1985-Present—Fred Sheridan

Program Office 325 (formerly 383 until August 1993)
- November 1984-December 1986—Captain Ed Mortimer
- December 1986-February 1989—Captain William Pfister
- February 1989-August 1991—Captain James Todd
- August 1991-June 1994—Captain Ted Doroshenk

OTHER CONTRACTING PERSONNEL

Contract No. N00024-1985-C-2115 (Penn Ship)

Final approval of NAVSEA Business Clearance Memorandum for Contract No. N00024-1985-C-2115 signed by Frank B. Ford, Office of Assistant Secretary of the Navy (Shipbuilding and Logistics) on April 26, 1985.

NAVSEA Contracting Officer: Awarded Contract and Modifications P00001, 4 and 8—John A. Kimener

Modifications P00002, 3, 5–7 and 10–20 (P00009 never issued)—Harold V. Hanson

Contract No. N000024-1990-C-2300 (Tampa Ship)

Final approval for NAVSEA Justification and Approval to Procure Other Than Full and Open Competition, signed by Frank W. Swofford, Principal Deputy for the Assistant Secretary of the Navy (Shipbuilding and Logistics), on November 16, 1989.

NAVSEA Contracting Officers: Awarded Contract and Modifications P00019, 21 and 22—Harold V. Hanson

Modifications P00001–18 and P00020—Joseph Novak.

Senator MCCAIN. Again, I am not talking about people putting money in their pockets, Mr. Vander Schaaf. I am talking about people making decisions which, on the face of it, were wrong decisions.

Mr. VANDER SCHAAF. Absolutely.

Senator MCCAIN. Let me just give you an example of what I am talking about. You have, three or four times, alluded in your testimony to this defense industrial base as possibly being a reason for the contract being awarded to Tampa. Are you aware that on 13

December 1988, Secretary Ball, Secretary of the Navy, writes to Congress stating that the closure of three shipyards, Penn Ship, Bethlehem Steel, and Tampa Shipyards, would have only a minimal impact on the shipbuilding industrial base——

Mr. VANDER SCHAAF. I am not aware of that.

Senator MCCAIN [continuing.] And that payments of any premiums for contracts to keep any of these yards alive was not justified? So the Secretary of the Navy writes to Congress, says that these three shipyards, actually, two of the three that are involved in this debacle, would have, in his words, in his letter, only a minimal impact on the shipbuilding industrial base, and yet, on November 16, 1989, less than a year later, the Navy awards a fixed-price contract to who, to Tampa Shipyards, and from who——

Mr. VANDER SCHAAF. Penn Ship.

Senator MCCAIN. To Penn Ship, both of whom are viewed as minimal by the Secretary of the Navy. So how can you even consider that a decision was made on the grounds of the defense industrial base when the guy who is the head of the Navy says that they have minimal impact?

Mr. VANDER SCHAAF. I certainly am not—and I made my testimony very clear to Senator Roth this morning—I do not believe that that decision that this was industrial base was a proper decision. As I just went through the testimony, I will go find that later Secretary of the Navy determination and study and make that part of the record and take a look at that. We did not look at that as part of our original audit, Senator McCain, and I will do that for you and personally try to get to the bottom of it. That is all I can do.[1]

Senator MCCAIN. Did you talk to the contracting officers that were——

Mr. VANDER SCHAAF. As far as I know, we did, in all cases, at length.

Senator MCCAIN. We may have to swear in your associate and talk to him, because I would like to know from your associate who talked to them if they were asked if political influence was part of that decision making process. Were they asked that?

Mr. VANDER SCHAAF. Do you want me to bring him in and swear him in?

Senator MCCAIN. Sure.

Mr. VANDER SCHAAF. Which one of you wants to address that? Give the Subcommittee your name and raise your right hand and get sworn in here.

Senator MCCAIN. If you talked to the contracting officers. Otherwise, I do not need you.

Mr. STAEHLING. My name is Timothy J. Staehling, a project manager in the Inspector General's Office.

Chairman ROTH. If you will, please stand and raise your right hand.

Do you swear the testimony you will give before this Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. STAEHLING. I do.

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[1] The information was previously printed on page 20.

Chairman ROTH. Please be seated.

Senator MCCAIN. You might identify yourself also, sir.

Mr. COLE. My name is David Cole. I am an auditor working for Mr. Stachling.

Senator MCCAIN. Did you speak to the contracting officers, either one of you?

Mr. COLE. Yes.

Mr. STAEHLING. Yes, we both did. During the conversation, inferences were made that certain political pressures were applied. The NAVSEA contracting officers did not get into any details, but it was alluded during these conversations that political pressure may have been applied in these awards.

Senator MCCAIN. Did you pursue that?

Mr. STAEHLING. As best we could. We asked some additional questions and the answers were very evasive. They chose not to answer certain questions during our conversations. It was very hard to get any additional answers, let us put it that way, Senator.

Senator MCCAIN. They alluded to political pressures but refused to be specific. Is that correct?

Mr. STAEHLING. That is correct.

Senator MCCAIN. Do they have some obligation to be forthcoming to you?

Mr. STAEHLING. Yes, they do.

Senator MCCAIN. Did it bother you that they were not?

Mr. STAEHLING. Yes, it did, and we are not required to issue subpoenas within the Government to get answers. It is the responsibility of the people within the Government to give us the answers, to give us the information that we need to do the proper audit. It did bother us quite a bit and we documented it in our files and several letters went back and forth between the IG and the NAVSEA regarding certain questions. But the answers were hard to get. It took them a little time to give us some answers. They did not just volunteer the answers.

Senator MCCAIN. Do you have any idea what kind of political pressures they were referring to?

Mr. STAEHLING. In the case of the Penn Ship award, they alluded to some pressures from people in the State of Pennsylvania. They did not give specific names. It could have been within the Philadelphia area, too.

In the case of Tampa Ship, there may have been similar pressure—we really did not get into Tampa Ship that much. Our review mainly centered on the award to Penn Ship and administration of that award and the eventual termination. I cannot speak too much about Tampa Ship.

But in the case of Penn Ship, it did come out that there was some political pressure being applied to give the award to Penn Ship.

Senator MCCAIN. Mr. Chairman, I think that with the cloud of allegations that are surrounding this issue, that both the innocent and some who may be guilty should be protected here and I would suggest that we should ask Mr. Vander Schaaf and his staff to go back and pursue allegations of political pressure. If this is not resolved one way or another, I think it would leave a certain cloud over the whole issue.

I wonder if you could go back and pursue that further, or would that not be a productive exercise, Mr. Vander Schaaf?

Mr. VANDER SCHAAF. I am not sure it would be very productive, sir. Why the Navy gave into political pressure has to be a question, if, in fact, it was applied. Sometimes the process works. They need appropriations to get the job done. I do not know all the details.

I can tell you, one of the senior Navy acquisition officials who was in office when the oiler contract award went to Penn Ship later was convicted of Federal crimes. There is no doubt about it. He served jail time. But I cannot link him to this matter. Shipbuilding was not his area. I think going back and trying to rehash dealings between the Congress and the Navy several years ago would not be very productive at this point.

The Naval Investigative Service has an ongoing case. They also looked at this award process in 1989. I can go through with you what they looked at. I have it right in front of me. They did not look at the question of whether political pressures caused the award to go to Penn Ship.

Obviously, as I testified this morning, it looked ridiculous to me on the face of it that Penn Ship could produce those ships at the price they bid, underbidding the existing producer, the designer of the ships, at a higher cost labor rate, with a less capable labor force or a workforce that had not been activated for several years. To expect them to come in at ten percent or so underneath the existing producer, to me, was absolutely on its face ridiculous.

A contracting officer or somebody else in the system has to stand up and say, darn it, I am not going to do it and I am not putting my name on this contract, or point out and put in his file that he was told to go out and contract by so-and-so at that point and make it a matter of record. Records like that are not there in this case.

Senator MCCAIN. Mr. Vander Schaaf, there is a big vacancy here——

Mr. VANDER SCHAAF. I do not disagree.

Senator MCCAIN [continuing.] And let me go through it again. That is that a contract was awarded to Tampa Shipyards when another shipyard had put in a lower bid——

Mr. VANDER SCHAAF. And there was every reason to——

Senator MCCAIN [continuing.] And bandied about was the prospect that perhaps the defense industrial base had something to do with it. We know that a letter was written a year before from the Secretary of the Navy indicating that neither Penn nor Tampa Shipyards would have anything but a minimal impact on the shipbuilding industrial base, so there must be a reason.

There must have been a reason why that decision was made to go to Tampa Shipyards. If it was not a defense industrial base, if it was not because of low bid, then there had to be some reason for a contract being awarded the way it was, and I think that is a very, very important question, because there is——

Mr. VANDER SCHAAF. And I will try——

Senator MCCAIN. Let me just finish. I am not interrupting you, Mr. Vander Schaaf—often. [Laughter.]

There are allegations now, or surmises by some, that if the contract had gone to Avondale, that then these two ships would have been completed at Avondale and we would not have the $400 mil-

lion investment sitting out there in the James River. So I do believe that that is an important part of this scenario.

Mr. VANDER SCHAAF. I agree with you on that part. I can go back and I can—I learned at noon, as I told Chairman Roth, that I had found out that the Navy did do some sort of a Secretary of the Navy-level review. I can find out who did that, what they were about, under what kind of guidance they did this review, and go investigate that matter.

It is not going to be determinative in a sense of affixing absolute responsibility, probably, or if it does, it is going to be somebody who has left the Navy and over whom we have no jurisdiction. But I will come back to the Subcommittee with that information.[1] I do not want to sit here and put tags on people when I do not have the evidence at the moment to support that.

Since I do know about this other study that supposedly backs up this industrial base decision because we did not audit it. But we clearly have a dichotomy. I never heard, until you just mentioned it that Secretary Ball had opined with respect to the necessity of keeping these three particular producers alive. I have never heard of that letter before. It is certainly in direct conflict with what Secretary—who was Secretary at the point this was awarded? Hold on a minute. I put my notes away with all the names on them.

Senator MCCAIN. I will be through in just a minute, Mr. Chairman. I apologize for the inordinate length, but I think——

Mr. VANDER SCHAAF. Secretary Garrett was in office at the point when Secretary Ball's position was reversed.

Senator MCCAIN. Let me just say, my view of this issue is that, one, there are people who are responsible. Whether they have left or not, if we operate under the assumption that when people leave office, they are no longer responsible for the things they do while they are in those positions, I think we would be setting a very dangerous precedent.

Second of all, the forces that cause these decisions to be made, I believe, are the crux of this hearing, because even if we go back and punish those responsible, we still want to prevent a recurrence of this again. If there was undue pressure from somewhere that dictated a decision that took a $400 million investment, and even though there would have been significant cost overruns, the Navy would still have two oilers, versus the condition we have today, I think that is of fundamental importance in this investigation.

Let me say, in closing, and I apologize for the expenditure of time, Mr. Chairman, but Mr. Vander Schaaf, I have appreciated the job you have done for many years, and I am a great admirer of yours. We may have had our difference of opinion, and I hope that this exchange does not—I can assure you, it does not affect my respect for your work.

I hope you will go back and look at this in light of our exchange here, because it hurts so much. As you know, if has been all over the media, it has been all over the television, as it should be. I am not decrying that. I am decrying that situations arise that the American people are absolutely outraged that their money, again,

[1] The information was previously printed on page 20.

is being wasted in such a terrible and inefficient and wasteful and possibly criminal fashion. I thank you. Do you want to respond?

Mr. VANDER SCHAAF. No, I appreciate it. I do not have any hard feelings. You are easy, next to some of the people I fight with in the Pentagon. [Laughter.]

Senator MCCAIN. I find that insulting. [Laughter.]

Thank you, Mr. Chairman.

Chairman ROTH. That is not the John McCain I know. [Laughter.]

I would ask that a copy of that letter be put in the record.[1]

Chairman ROTH. I think that is all the questions we have at this time, Mr. Vander Schaaf, but at the completion of this further investigation——

Mr. VANDER SCHAAF. I will certainly follow up on that last point that Senator McCain brought up.

Chairman ROTH. We may have additional questions. The record will be kept open for written questions, as well.

Thank you very much, Mr. Vander Schaaf, and Mr. Staehling and Mr. Cole, as well.

Chairman ROTH. Our next panel of witnesses will be Captain Pete Schrodt and Captain Karl M. Klein. Both Captain Schrodt and Captain Klein are retired U.S. Navy officers who served as Supervisors of Shipbuilding, or so-called SUPSHIPs, in charge of this Navy T–AO oiler contract. Captain Schrodt was the SUPSHIP overseeing Penn Ship and Captain Klein was the SUPSHIP in charge of Tampa Shipyards.

Gentlemen, we appreciate your willingness to appear before the Subcommittee and we look forward to your testimony. Would you please both remain standing and raise your right hands?

Do you swear the testimony you will give before this Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Captain SCHRODT. I do.

Captain KLEIN. I do.

Chairman ROTH. Captain Schrodt, we will start with you. Gentlemen, I apologize to both of you for the long delay and appreciate your being here.

TESTIMONY OF CAPTAIN C.J. PETE SCHRODT,[2] U.S. NAVY, RETIRED, FORMER SUPERVISOR OF SHIPBUILDING, BROOKLYN, NY

Captain SCHRODT. Good afternoon, Mr. Chairman and Members of the Subcommittee. I am Captain Pete Schrodt, U.S. Navy, Retired. I am an engineer educated at the University of Nebraska, Massachusetts Institute of Technology, and Cornell University.

I was commissioned in the U.S. Navy in 1965 and served in a variety of sea and shore tours. I have served on four ships, a tour in Vietnam as a skipper of a patrol boat, one Naval shipyard, six Supervisor of Shipbuilding commands, and on the Chief of Naval Operations Staff. Of the six Supervisor of Shipbuilding tours, three involved, to some degree or another, new construction. I have had

[1] The document referred to was marked Exhibit No. 3 and can be found on page 191.
[2] The prepared statement of Captain Schrodt appears in the Appendix on page 127.

three tours of duty as Officer in Charge and two tours as a Commanding Officer. I retired with 36 years of service on June 30, 1992.

I appreciate the opportunity to testify before you today regarding the Navy T–AO 187 oiler contract. For the record, I would like to submit my complete statement, which I will summarize in my testimony.

Chairman ROTH. Your complete statements will be included, as if read.

Captain SCHRODT. Thank you, Mr. Chairman.

I took command of Supervisor of Shipbuilding Conversion and Repair in Brooklyn, NY, in July 1986. In August 1987, the Naval Sea Systems Command procuring contracting officer transferred the responsibility for administration of the T–AO Class shipbuilding contract and all other Government contracts with Pennsylvania Shipbuilding Company, who I will refer to as Penn Ship, from the Supervisor of Shipbuilding Conversion and Repair, Portsmouth, VA, to Supervisor of Shipbuilding Conversion and Repair, Brooklyn, NY. As a result, I became the SUPSHIP in charge of administering this oiler contract that had been awarded to Penn Ship.

The Supervisor of Shipbuilding construction, conversion, and repair, referred to as SUPSHIP, is responsible for the administration and oversight of the U.S. Navy contracts awarded to private ship repair and shipbuilding firms in the SUPSHIP's geographical area of responsibility. In addition, the SUPSHIP also provides the procurement, administration, and oversight of the repair of Navy ships for the fleet that is accomplished in the private sector.

The initial T–AO contract awarded May 6, 1985, was a fixed-price, incentive contract for two ships with original target prices of $123 million and $100 million, respectively, with options for two additional ships. During August and September 1987, I, along with my staff, conducted a technical and engineering review of the actual work ongoing on T–AO 191, ship one of the contract. Based on this review, it was my opinion that Penn Ship did not have the artisans, the technical and core competencies, and the related shipbuilding skills in sufficient quantity to build and deliver any T–AO within the contract provisions, time frame, and price.

On October 14 and 15, 1987, I briefed the Commander Naval Sea Systems Command, Vice Admiral Rowdin, regarding the status of the contract. On November 5, 1987, at the direction of Vice Admiral Rowdin, I provided the same briefing to the senior staffs for the Commander of NAVSEA and to the Assistant Secretary of the Navy, Shipbuilding and Logistics, Secretary Pyatt. My evaluation was that Penn Ship could not build and deliver any T–AOs within the contract provisions. I recommended the contract be terminated at this time.

The Naval Sea Program Manager's T–AO Quarterly Review Conference was held at Penn Ship during the week of November 17, 1987. Based on this conference and the previous evaluation, I again briefed Navy Assistant Secretary Pyatt's staff on December 22, 1987. I provided my evaluation that Penn Ship could not build and deliver any T–AOs within the contract provisions, and I again recommended termination of the contract.

The week of March 1, 1988, I briefed the Commander of NAVSEA on the status of the contract, informing him that the contract costs were going up and progress was decreasing. I informed Vice Admiral Rowdin that there was little chance the first ship would be delivered on time, and if it was delivered, it would be way over budget. At this time, I was informed by the NAVSEA procuring contracting officer that negotiations between Penn Ship and the Navy were ongoing to remove two ships from the contract.

On May 27, 1988, progress payments to Penn Ship exceeded the ceiling price on T–AO 191, the first ship. I advised Penn Ship that additional payments exceeding the contract price per ship may not be forthcoming. The procuring contracting officer directed progress payments above the ceiling on the basis that the ceiling price of the contract did not apply to individual ships.

NAVSEA's Program Manager's T–AO Quarterly Review Conference was held at Penn Ship during the week of June 1, 1988. On June 16, 1988, NAVSEA announced the decision to transfer the third and fourth ships of the contract to Avondale Industries, Incorporated.

The new modified contracts with both Penn Ship and Avondale were fixed-price for the four T–AO ships provided in the Penn Ship contract. The price and delivery schedules of these were modified, and I have included specific details concerning these modifications in the statement I submitted for the record.

The new fixed-price contracts plus estimated costs for non-transferable work amounted to almost $58 million more than the originally-negotiated total ceiling price and more than $143 million over the original total target price.

During the week of November 29 to December 2, 1988, I again briefed the Commander of NAVSEA on the status of both ships. This would be 191 and 192. Penn Ship was not making the required progress and was significantly behind schedule to deliver either ship within the time frame and price of the modified contract requirements.

In fact, by this time, Penn Ship had practically stopped working on both ships, although an official "stop work" order was not issued until the February/March 1989 time frame. My evaluation was that Penn Ship could not deliver either ship within the time frame and price requirements of the contract. My recommendation was to terminate the contract with Penn Ship for T–AO 191 and 192.

By late 1988, Penn Ship's progress toward completing the ships diminished dramatically and the company's financial problems worsened. In an effort to extricate Penn Ship from these problems, the Navy approved an advance payment of at least $10 million. To maintain better control of these funds, they were placed in a special account that required an individual from my staff and Penn Ship's co-signatures on checks drawn on that account.

At this time, Penn Ship submitted several bills for questionable expenditures to be charged to this account. These included charges for new furniture for a home in Texas and the costs of bulldozing work on Texas property. In addition, Penn Ship also submitted a bill for payment of approximately $25,000 in United Way contributions that Penn Ship had deducted from employees' wages but never paid to United Way.

Another bill submitted for payment was for an employee's child support payments that were supposed to be deducted from the employee's salary and automatically transferred to beneficiaries. Penn Ship deducted but did not transfer the money, resulting in the employee being in arrears for child support payments.

My staff informed me that the subject Penn Ship employee was incarcerated for non-payment of child support. In summary, I rejected payment on any bill we found that was questionable.

My tour of duty as Commanding Officer, Supervisor of Shipbuilding, Conversion, and Repair in Brooklyn, NY, was completed on May 18, 1989. At that time, the status of T–AO 191 and 192 had remained unchanged since late 1988. No work was in progress. The first ship was approximately 80 percent completed and the second ship between 50 and 60 percent completed. I took command of Supervisor of Shipbuilding, Conversion, and Repair, San Francisco, CA, in June 1989.

In conclusion, Mr. Chairman, it is unfortunate that it took 2 years to terminate Penn Ship's contract. While both termination options, for default or for convenience, would have cost money, it would have been less expensive in the long run, in my opinion, to terminate as rapidly as possible.

I thank you for the opportunity to testify before you, sir, and I hope the information I provided makes this complex matter more understandable. I would be happy to answer any questions that I can and you may have of me. Thank you, sir.

Chairman ROTH. Let me ask one question, and then we are going to turn to you, Captain Klein, and let you make your statement, and then we will have questions for both of you.

A number of times, you recommended termination. Who had authority to terminate the contract?

Captain SCHRODT. NAVSEA, the contracting officer. Of course, they would have to get that, under my understanding, from higher authority, a contract of this size.

Chairman ROTH. The contracting officer has the——

Captain SCHRODT. The procuring contracting officer, yes, sir.

Chairman ROTH [continuing.] Has the authority to terminate, but, in fact, that authority had not been delegated to him?

Captain SCHRODT. I was not the contracting officer. That would be NAVSEA's procuring contracting officer.

Chairman ROTH. No, I understand that. But, again, my question was, who has the authority to actually terminate the contract?

Captain SCHRODT. It is my understanding that the NAVSEA procuring contracting officer, who works for the Commander, NAVSEA Systems Command has that authority.

Chairman ROTH. And he would have to go to higher authority to secure approval?

Captain SCHRODT. I would suggest that protocol, he would probably go, yes, to the Assistant Secretary of the Navy for Logistics, Shipbuilding and Logistics, Mr. Pyatt at that stage, sir.

Chairman ROTH. That would be the ultimate authority?

Captain SCHRODT. Yes, sir.

Chairman ROTH. Captain Klein, do you want to proceed?

TESTIMONY OF CAPTAIN KARL M. KLEIN,[1] U.S. NAVY, RETIRED, FORMER SUPERVISOR OF SHIPBUILDING, JACKSONVILLE, FL

Captain KLEIN. Yes, sir, Mr. Chairman. As you know, I have been asked by your staff to appear before the Subcommittee, to make an opening statement regarding my background and my experience as a Supervisor of Shipbuilding administering the Navy's T–AO and TAGOS contracts with Tampa Shipyards, and to answer your questions.

As for my background, I am an engineer educated at the Naval Academy and MIT. I was commissioned in the Navy in 1964 and served in a variety of sea and shore tours devoted to the engineering, construction, operation, and maintenance of ships and submarines. My duty stations have included four ships; the Portsmouth Naval Shipyard; the Naval Ship Repair Facility in Yokosuka, Japan; the staff of the Commander, Naval Surfaces Forces, Atlantic Fleet; and the Engineering and Planning Department of the Supervisor of Shipbuilding Office in Jacksonville, FL.

I headed the Naval Academy's School of Engineering from 1985 to 1989, and I was the Supervisor of Shipbuilding in Jacksonville (and, therefore, in Tampa, as well) from October 1989 until my retirement in June 1993. Since retirement, I have been on the faculty of Bishop Kenny High School in Jacksonville, FL.

When I assumed command in Jacksonville in October of 1989, I and my staff were aware that the Navy was considering Tampa Shipyards, which is a yard under my geographic area of responsibility, for a possible contract to complete two partially-constructed T–AO 187 Class oilers.

In November, we were informed that a letter contract had, in fact, been awarded for Tampa to complete the T–AO 191 by November of 1991, and the T–AO 192 by July of 1992. We immediately put together the core of a project team to administer the contract.

Within my Command, we had some corporate knowledge of Tampa Shipyards, none of it favorable. My first visit to the yard did little to relieve our concerns. While I found some of Tampa Shipyards' facilities exceptional and the enthusiasm of its president, Ralph Anselmi, to be high, I also found the yard generally filthy and littered with debris. I found no indication of an up-and-running management organization nor of the planning, scheduling, or other software systems required to back it up. The company had also lost money in each of the preceding 3 years.

While I voiced my concerns informally to my superiors in the Naval Sea Systems Command, who I will refer to as NAVSEA, there was nothing to be gained at this point in objecting to an awarded contract, so we concentrated our energies, instead, on getting the job off to as good a start as possible.

The start could not have been worse. En route from Pennsylvania in December of 1989, Tampa's towing contractor lost the 191 and it ran aground on the coast of North Carolina. It was later refloated by the Navy, and by February of 1990, both ships had been

[1] The prepared statement of Captain Klein appears in the Appendix on page 134.

finally delivered to Tampa. Damage to the 191 was significant, but it was repairable and fully insured.

Not much production progress ensued for the first several months, as Tampa was primarily engaged in moving not only the ships but also several hundred truck and railcar loads of equipment and material down from Pennsylvania. By June of 1990, however, Tampa had had enough time to establish a clear performance trend, and it was not good.

In June, we held our first Quarterly Progress Review, or QPR, in which both Tampa and SUPSHIP briefed representatives from NAVSEA and other interested commands. Tampa's report was upbeat; ours was not.

I followed up this and every QPR report with my own written assessment to NAVSEA. In that first report, I stated flatly that Tampa would not meet the contract delivery dates, that the company did not have the management capability in place to comply with the contract, that Tampa Shipyards was unwilling or unable to devote the necessary resources to the project, and that by every indicator available to me, Tampa was in serious financial trouble and lacked the cash and credit resources to adequately perform the requirements of the contract.

By November of 1990, it was patently obvious that Tampa could not complete the contract on time. Mr. Anselmi was replaced as Tampa's president by Alan Nierenberg, who, along with Tampa Shipyards' board chairman, George Steinbrenner, requested a contract extension, additional money, and relief from several clauses of the contract. NAVSEA denied this request.

Tampa Shipyards' performance continued to deteriorate, and by February of 1991, I projected a cost overrun of at least $6.5 million and reported that we saw no evidence that Tampa Shipyards had financing to cover the loss. We did have strong evidence, however, that Tampa was delinquent in paying vendors for material and services for which the Navy had already paid the shipyard under the small business exception to the Federal Acquisition Regulations.

Tampa had, by now, taken a clearly disputatious stand in the performance of the contract. Extravagant claims of delay and disruption were voiced by company officials, and in a QPR executive session, Mr. Nierenberg informed the Navy that unless relief were granted under the "as is, where is" clause of the contract, Tampa would not continue to devote a large amount of the company's assets to the project.

Chairman ROTH. Could you explain the so-called "as is, where is" clause?

Captain KLEIN. Yes, sir. In the original contract, the letter contract, it stated that Tampa would accept the ships "as is, where is" and complete them.

Chairman ROTH. And this was a fixed price contract?

Captain KLEIN. Yes, sir.

Chairman ROTH. In which they undertook the obligation to complete it?

Captain KLEIN. Yes, sir.

Chairman ROTH. Was there any contractual basis for Tampa Shipyards to say that it would not continue to devote company assets to this project?

Captain KLEIN. No, sir. We viewed that as a threat.

Chairman ROTH. Please proceed.

Captain KLEIN. If, in fact, they carried out the threat, that would have been grounds for immediate termination, if they stopped work.

Chairman ROTH. Let me ask this question. The contract could be terminated for convenience, could it not?

Captain KLEIN. No, sir, default. Oh, anytime, you can terminate for convenience.

Chairman ROTH. The Navy has that right? It has to have no reason beyond the convenience of the Government?

Captain KLEIN. Yes, sir, but I am talking about termination for default.

Chairman ROTH. Right, yes.

Captain KLEIN. If he carried out his threat to stop work, then he would be terminated for default.

Chairman ROTH. Right.

Captain KLEIN. Shall I continue, sir?

Chairman ROTH. Please proceed.

Captain KLEIN. After lengthy negotiations, NAVSEA and Tampa agreed, as of April of 1991, to a contract modification known as P–00012, which raised the ceiling price of the contract by $10.2 million, authorized a lump sum progress payment of $3.2 million, and extended the completion dates for the T–AO 191 and 192 to May and December 1992, respectively. Tampa, for its part, waived its claims and promised to bring delinquent vendor accounts current.

At this point, the situation worsened dramatically when the Navy was forced to award Tampa a contract for the construction of the TAGOS 23. NAVSEA, as part of its pre-award survey of Tampa Shipyards, assembled enough financial data to conclude that the company would lose money on the TAGOS contract and that it had insufficient financial assets or credit to sustain the loss. The contract was awarded only after the Small Business Administration issued Tampa Shipyards a certificate of competency.

Chairman ROTH. Let me ask you a question there, Captain Klein.

Captain KLEIN. Sure.

Chairman ROTH. You say that Tampa Shipyards was compelled to move ahead. The contract was awarded only after the Small Business Administration issued Tampa Shipyards a certificate of competency. You say in the first sentence of that paragraph, "At this point, the situation worsened dramatically, when the Navy was forced—"

Captain KLEIN. Forced, yes, sir.

Chairman ROTH [continuing.] "Was forced to award Tampa Shipyards a contract for the construction of TAGOS 23." Then, below, you say, if I understand it, "The contract was awarded only after the Small Business Administration issued Tampa Shipyards a certificate of competency." How did that force the Navy to so award the oiler contract?

Captain KLEIN. As contracting officer, you can declare a contractor non-responsible if he does not have the financial wherewithal

to complete the contract. However, if he is small business and the Small Business Administration overrules your declaration of nonresponsibility and declares that he is, in fact, a competent shipyard in all of the rules of both technical and financial stability, then you have no choice under the law but to award the contract.

Chairman ROTH. Please proceed.

Captain KLEIN. That is the Federal Acquisition Regulations, sir.

So in June of 1991, I reported that without a dramatic improvement in productivity (not then apparent) Tampa would not complete the T–AOs within the then-revised completion date or revised contract price. I also reported that as of June 4, 1991, Tampa's accounts payable aged report still exceeded $450,000, despite the promise by the company to bring accounts payable current, and that, based on informal complaints we had received from the yard's vendors, the report was understated.

In August of 1991 and again in November of 1991, I reported that evidence was accumulating that, despite the P–00012 change and despite the TAGOS award, which, in the short term, should have improved Tampa's cash flow, and despite personal lines of credit from George Steinbrenner, Tampa's financial condition continued to deteriorate and that its accounts payable aged report was growing, to $2.8 million by October. Tampa's rate of production progress, previously insufficient to support the revised T–AO completion dates, was also declining.

For the next several months, progress on the T–AOs was minimal while Tampa put most of its assets on the TAGOS contract and on whatever short-term commercial work it could bring into the yard. Tampa's financial condition continued to deteriorate, and I reported steady increases in the aged accounts payable reports, up to $10 million.

The company's fiscal year 1991 financial statement showed 5 straight years of losses and contained the statement by its independent accountants that the company, "has given notice to its lenders of its failure to comply with certain requirements of its credit agreements. These factors raise substantial doubt about the company's ability to continue as a going concern."

In March of 1992, Tampa formally acknowledged to the Navy its inability to meet the revised T–AO contract delivery dates, a capital shortage impacting its ability to purchase material and equipment, and that, "a working capital infusion is required in order for us to complete construction of the T–AOs in a timely manner."

NAVSEA then issued Tampa a "cure notice" on the T–AO contract, citing lack of progress and continuing shortfall of necessary working capital, and I released a "bellringer" message alerting Navy and Defense Department hierarchy of the distinct possibility of TSI's bankruptcy and of the company's inability to complete either the T–AO or TAGOS contracts. In that message——

Chairman ROTH. Captain Klein, could you define for us what a "bellringer" message is?

Captain KLEIN. Yes, sir. A "bellringer" message is a message developed by the Department of Defense in which an administering contract officer, an on-scene contracting officer administering the contract, alerts higher authority of significant potential impact, in this case, the bankruptcy of the company and the inability to com-

plete the ships. It is designed to send that message to the highest levels of the Department of Defense and Navy managers.

Chairman ROTH. Let me ask this question. Captain Schrodt mentioned several times that he recommended termination of the earlier contract. You speak of releasing a "bellringer" message. Are they pretty much equivalent?

Captain SCHRODT. When I recommended termination, sir, the bellringer procedure or process had not come into existence yet.

Chairman ROTH. I see.

Captain SCHRODT. It was something that grew out of some problems across the board with——

Captain KLEIN. The A–12.

Captain SCHRODT. I was not going to say that, but it grew out of other contracting problems that the Navy or other DoD may have had that basically shielded people on site like Captain Klein and myself, so we could go front and center to the highest authority without fear. The bellringer is put in existence to do that.

Chairman ROTH. Before the bellringer, you could not do that?

Captain SCHRODT. Sure, you could. I did, sir. It just meant that you may not be shielded. You had no procedure. It was based upon your own judgment of when to call them, yes, sir.

Chairman ROTH. I see.

Captain KLEIN. In that message, I also reported, and I will quote again, "interest on the part of staffers from the House Appropriations Committee and several Congressmen, local and otherwise." On May 26, 1992, Tampa submitted to NAVSEA a request for extraordinary relief under Public Law 85–804.

In early June 1992, Congressmen Murtha and Young visited Tampa Shipyards, accompanied by Mr. Dan Howard, Undersecretary of the Navy. A few days later, Mr. Gerald Cann, Assistant Secretary of the Navy, also visited the yard, along with representatives of NAVSEA.

At NAVSEA's request, KPMG Peat Marwick reviewed Tampa's financial condition and reported that, as of 15 June 1992, past due accounts had risen to over $20 million. Mr. Steinbrenner also hired a consulting firm to review Tampa's performance on the T–AO contract. A copy of the consultant's report was provided to the Navy and confirmed our contention that Tampa had not been properly managed, staffed, or organized to complete the contract. Shortly after the report was completed, Mr. Nierenberg was replaced as Tampa's president by Stuart M. Novak.

After a series of lengthy discussions with Tampa Ship, NAVSEA, on August 7, 1992, denied the company's request for extraordinary relief. The denial stated, in part, that even if Tampa received the money requested, the company still might not be able to finish the ships. I and my staff made contingency plans to remove the ships and other Navy property from the yard in the event of bankruptcy.

Tampa Shipyards managed to hang on until October of 1992, when the Fiscal Year 1993 Appropriations Act directed the Navy to provide the company with extra contractual relief in the form of a $45 million upward adjustment to the T–AO contract, including a $12 million cash payment. The Act also required the Maritime Administration to pay Tampa Shipyards $13 million in cash to settle a disputed claim on another, unrelated contract. NAVSEA nego-

tiated contract revision P–00018 with Tampa Shipyards to fulfill the requirements of the Congressional mandate and to extend the two completion dates to February and October of 1994.

Chairman ROTH. Can I ask you a question at this point? What were the requirements of the Congressional mandate?

Captain KLEIN. I can only remember some of it, but I remember some of it quite well. It said, notwithstanding any other laws and regulations, the Navy is directed to, essentially, pay Tampa Shipyards $45 million, of which $12 million is in cash. I paraphrased the last part.

Chairman ROTH. Did it state anything beyond that? Did it go into further detail?

Captain KLEIN. It did say that the Navy was to negotiate with Tampa the waiving of claims that Tampa then held against the Navy. To my knowledge, that is all it said. It is the Act. It is available.

Chairman ROTH. Please proceed.

Captain KLEIN. Congressional action saved Tampa Shipyards from bankruptcy in 1992, but the Navy saw no benefit from the infusion of cash to the company because Tampa still failed to put in place an adequate production, planning, material, subcontractor control, quality assurance, or test and trial organizations. It failed to correct numerous production errors that had accumulated or to bring current its overdue accounts.

Progress on the T–AOs remained painfully slow and Tampa was falling behind on its engineering and production schedules on the TAGOS. By November 1992, Tampa had already incurred a cost overrun on the TAGOS project of 16,700 man hours, or 57 percent of the man hours earned.

By January of 1993, Tampa's financial condition had thus, again, worsened, to the point that the company requested the Navy release $5 million in retentions on the T–AO and TAGOS contracts to pay past due accounts with vendors and subcontractors who had either stopped work or refused to ship material. The Navy did agree to exchange Tampa letters of credit for performance bonds to free up some working capital, but disapproved the release of retentions, noting that that would constitute an "unusual progress payment".

At this point, triggered by Tampa's violation of several specific terms of the T–AO and TAGOS contracts, I stopped progress payments and released my third bellringer message, again advising DoD and Navy that the company's eventual failure was likely.

By March of 1993, Tampa still had not produced an acceptable T–AO progressing system, as required by the P–00018 contract modification. In April, I finally did receive a progressing system I could at least provisionally approve, and NAVSEA agreed to additional modifications on the T–AO and TAGOS contracts that, together, freed some $7 million for, this time, direct payment to Tampa's vendors and subcontractors.

In May of 1993, however, I reported that, despite these cash infusions, my overall prognosis remained bleak. "Tampa Shipyards' high debt load, inadequate management, inefficient production, and exploited vendor base together represent too great a hurdle for the

company to achieve sustainable profitability." Failure was inevitable.

In June of 1993, I was notified by Tampa Shipyards that unless the Navy assumed immediate payment for rental lift equipment used for painting and other drydock work, the vendor would remove the equipment, which, in turn, would result in termination of affected work on the T–AOs. On June 17, 1993, I released another bellringer message reporting this latest development and reiterating my most recent prediction of Tampa's ultimate failure. As planned, a week later, I was relieved as Supervisor of Shipbuilding and retired from the Navy.

I hope this testimony is helpful in your investigation, Senator, and if I have raised any questions, I will try my best to answer them, to the best of my recollection.

Chairman ROTH. First, let me say to both of you, I appreciate your being here. Your testimony is, indeed, most helpful. We will want to proceed first with Captain Schrodt and then you, Captain Klein, but let me ask one quick question of you, Captain Klein, on this bellringer again, through which you warned that Tampa Shipyards was not going to complete the contract. Was that equivalent to a recommendation to terminate the contract?

Captain KLEIN. No, sir. I did not make a recommendation to terminate. Termination is only useful, I think, if you can manage to terminate and not have to pay more money in the termination than if you continue with the work, and that was a prerequisite of the NAVSEA PCO, the procuring contracting officer. I simply provided the worm's eye view of what was happening at the local level and let that decision remain up with NAVSEA, where they knew what litigative risk they were taking.

Chairman ROTH. I want to ask some questions about the organization of the Navy and who was responsible for what. But for purposes of the record, you say you retired as planned .

Captain KLEIN. Yes, sir.

Chairman ROTH. Was your retirement brought about in any way by dissatisfaction on the part of the Navy because you sent bellringers?

Captain KLEIN. I cannot imagine that, no, sir. They gave me a 6-month extension in the job, as opposed to making me leave early, so that was 6 months later than planned.

Chairman ROTH. That was my understanding. I thought the record ought to be clear on that matter.

Captain KLEIN. Yes, sir.

Chairman ROTH. Captain Schrodt, we have an acquisition chain of command here,[1] and as I understand it, the SUPSHIP is on the right side of the table of organization. Exactly what is the responsibility of the SUPSHIP?

Captain SCHRODT. The primary responsibility, outside of the military command, Senator, is to provide administrative oversight to the contracts that are awarded to those private contractors in his geographical area. The boundaries of the geographical area have basically evolved from the old Naval districts.

[1] The document referred to was marked Exhibit No. 1, and appears on page 189.

In addition to that, we do basically the procurement under a master ship repair contract and oversight for repair of fleet ships. If I looked at the repair, new construction workload, probably 80 percent of the time, in those SUPSHIPs where they had both repair and new construction, 80 percent of your time may well be put into repair, but then 80 percent of your money outflow to the private sector was probably in new construction.

Chairman ROTH. One of the things that concerns me is that the contracting officer holds responsibility for directly administering the contracts. Is that in fact the case? And what is the contracting officer's responsibility?

Captain SCHRODT. The contracting officer's responsibility is to award the contract and provide the requirements under FAR and DFAR that directs the supervisor in the extent of the responsibility of his administration and oversight. If you read the Federal Acquisition Regulations and Defense Federal Acquisition Regulations, it will say the contracting officer then directs which part of the administrative oversight that the on-site supervisor will oversee on those contracts awarded by the NAVSEA procuring contracting officer.

Chairman ROTH. Let me ask you this. The on-site supervisor reports to the contracting officer, is that correct?

Captain SCHRODT. No, sir.

Chairman ROTH. He does not?

Captain SCHRODT. No, sir. Report up my chain of command, which is through the Deputy Commander of the Naval Shipyards and the Supervisor of Shipbuilding.

Chairman ROTH. I see. The administration is through the SUPSHIP?

Captain SCHRODT. Yes, sir. The best way to understand the reporting is, I guess, who writes your evaluations and your performance, and that is not written by the contracting officers. That is written by and signed by the Commander of NAVSEA Systems Command, which is the same individual that the contracting officer reports to.

Chairman ROTH. One of my concerns is that this division of responsibility does not seem to make sense. The administration is carried out through the SUPSHIPs but technically the contracting officer has the authority to terminate the contract. There thus seems to be a split or a division between the two functions.

For example, you make recommendations to terminate, but that goes up from SUPSHIP on up to the Commander of Naval Sea Systems Command.

Captain SCHRODT. Deputy Commander to the Commander of Naval Sea Systems Command.

Chairman ROTH. And then it would have to come down to the contracting officer, technically.

Captain SCHRODT. Yes, sir. But, obviously, at the same time, I will be telling the contracting officer across that, yes, I am doing this. In fact, the contracting officer in charge at the time I had made my recommendations was at the meeting where I made my recommendations.

The Supervisor of Shipbuilding, sir, are unique, probably, in the way they administer contracts in regard to how this is structured.

Chairman ROTH. When did you first notify your superiors about your concerns?

Captain SCHRODT. The contract, of course, was awarded in May of 1985. It was shifted to my responsibility in August of 1987, some 27 months after Penn Ship had started working on it. I spent 2 months with my staff reviewing the contract, reviewing on-site work, and upon determination that it was basically a technical decision, after 2 years, there was not sufficient artisan and skilled workmen on site to do this job, I notified Vice Admiral Rowdin in a meeting in the middle of October of 1987, sir.

Chairman ROTH. Did you recommend termination at that time?

Captain SCHRODT. The question he raised was, what should we do, and I said, the best way is to terminate, either convenience or default, and at that time, I did not think you could get a default termination, so it would have been a convenience of the Government.

Chairman ROTH. Which they had the authority to do as we brought out earlier.

Captain SCHRODT. Yes, sir.

Chairman ROTH. What action was taken on your recommendation?

Captain SCHRODT. The Vice Admiral was very supportive and turned to his senior staff at the time and directed them to fix the problem. And, sir, 8 months after that recommendation, 50 percent of that contract was terminated. Two ships were, in fact, removed, were, in fact, sent to Avondale, and those two ships were, in fact, finished and delivered to the Navy under budget.

Chairman ROTH. When was the rest of the contract terminated?

Captain SCHRODT. It was terminated about 3 months after I left the Supervisor of Shipbuilding's Office. I left in May of 1989 and proceeded to San Francisco as Commanding Officer there, and I believe it was in August of 1989, although I found that out later. I did not follow it very closely after I went to the West Coast.

Chairman ROTH. You had other responsibilities.

Captain SCHRODT. Yes, sir.

Chairman ROTH. But there was over a 2-year period between your initial recommendation and the actual time it was terminated?

Captain SCHRODT. Yes. I came on the scene in August of 1987. It was fortunate, because I had not been involved, so I had a clear, clean look at it with my staff and made the recommendation. Then, 2 years later, the total termination of the contract had taken place.

Chairman ROTH. What steps did the Navy take to assist Penn Ship financially during the time of this contract?

Captain SCHRODT. Other than what I mentioned in my opening statement concerning the $10 million special account—the contract when it was initially awarded was unique in the fact that it had accelerated progress payments built into the contract.

Chairman ROTH. Is that a common practice?

Captain SCHRODT. Based on my experience, no, sir, because I have never seen it before. Basically, what it comes down to is, normally in a contract, if you do ten percent of the work, or military invoicing, then the contractor will submit that ten percent progress

and the Government would then reimburse the contractor for ten percent or something less than that.

In the case of this contract, we paid if the contractor put forward ten percent billing and work accomplished on the ship, we would probably pay considerably more without the contract. It was probably up to 15 percent or more, which meant we over-funded the contractor up front. It is unique. I had not seen it before.

Chairman ROTH. In June 1988, the Navy and Penn Ship reached an agreement to have the two remaining ships in the original contract built by another contractor, since Penn Ship had not yet begun construction on them. What benefit was that to Penn Ship?

Captain SCHRODT. At this stage, Penn Ship had, obviously, considerable outstanding invoices for material, other expenses. Financially, they were not in the best condition. By doing this, it basically leveled the playing field. Penn Ship had their financial problems taken care of. They increased the target price for the first two ships by $108 million, I believe it was, total. It went up to $331 from $223, which is $108 million delta, and it gave them the best opportunity to finish the other two ships. It was short-lived. It did not work, because 6 months later, obviously, in the latter part of 1988, we were in trouble.

Chairman ROTH. And the fact is that the Navy gave $108 million additional money for nothing that the contractor was not under obligation to do anyway, is that not correct? They had an obligation to produce the two ships, did they not?

Captain SCHRODT. The original contract obligation was to produce the two ships. Now, they had to produce the same two ships, and yes, the target price was raised $108 million, yes, sir. Were the ships better for that $108 million? No, sir.

Chairman ROTH. Let me now turn, if I may, to Captain Klein. Captain Klein, you examined the facility at Tampa Shipyards and the ships as soon as they arrived in Tampa. Based on what you observed, did you think that Tampa Shipyards was capable of completing the ships?

Captain KLEIN. No, sir. The shipyard had adequate facilities, but that was about it. The yard was also, as I mentioned, filthy, littered with debris, and the company did not have in place the kind of management team or skilled craftsmen in sufficient numbers to do the job, and, especially, it did not have the financing.

Chairman ROTH. To your knowledge, was any pre-award survey made of Tampa Shipyards?

Captain KLEIN. To my knowledge, I know NAVSEA visited the yard before the award was made. We at SUPSHIP did not participate. Certainly, we provided no written participation in whatever the pre-award survey was. But much of that occurred before I took command at SUPSHIP, so I really do not know precisely what pre-award surveys were handled out of NAVSEA.

Chairman ROTH. What was your understanding of why the contract was awarded to Tampa Shipyards?

Captain KLEIN. I can only give you a worm's eye view. Part of the worm's eye view, I must admit, comes from press articles that I read about the award, but that it was done with some definite political influence on the part of Members of Congress. The decision was made in the Secretary of the Navy's office, outside of the

normal contracting process that NAVSEA—the procedures that NAVSEA follows. But I have no personal knowledge of what went on.

Chairman ROTH. Captain Klein, were you aware of the letter sent by Secretary Ball in 1988 indicating that Tampa Shipyards and two other shipyards were not considered necessary to our industrial base?

Captain KLEIN. No, sir, I was not aware of the letters. I firmly agree, in the case of Tampa.

Chairman ROTH. But was it your understanding that was the basis of awarding the contract?

Captain KLEIN. My understanding was preservation of the industrial base, yes, sir.

Chairman ROTH. And if that was the case, why did the Navy not grant the $25 million bailout?

Captain KLEIN. Again, I cannot answer that from my own personal knowledge. I would have to assume that the original decision was considered a sunk cost. It would not make any sense to put more money after money already wasted.

Chairman ROTH. Is it true that Tampa Shipyards received special treatment because they qualified as a small business?

Captain KLEIN. Yes, sir. Under the small business exception to the Federal Acquisition Regulations, and if I recall, that is clause 52.216–7, the Navy pays in advance for material and vendor services invoiced by the contractor, before they are even received, and that is standard for small business.

Chairman ROTH. Do you have any knowledge as to how Tampa Shipyards became classified as a small business, how it came about, who initiated it?

Captain KLEIN. Yes, sir. The law says, as I recall, that as long as the company has less than 1,000 employees—of course, the determination is made in the previous fiscal year when the financial reports come in—that that company, then, is classified as a small business, and the company is looked at by itself, not as part of the assets, perhaps, of some other larger company, if that company is separately incorporated.

Chairman ROTH. Did Tampa Shipyards use this money to promptly pay its vendors and subcontractors?

Captain KLEIN. We have clear evidence that they did not.

Chairman ROTH. What was it used for?

Captain KLEIN. That, I cannot tell you.

Chairman ROTH. But you know that it was not used to pay vendors and subcontractors? Let me ask you, how do you know what it was not used for but not know what it was?

Captain KLEIN. Our opportunity for surveillance of the money does not include what Tampa actually uses it for. Under the contract, the most we can do is to inspect Tampa's books, using the Defense Contract Audit Agency to do that. So we first began to find out that Tampa was not, in fact, making payments to its subcontractors.

First, when we began to get complaints from the subcontractors that they were not being paid on time, we sent the DCAA, the audit agency, in to review, and then immediately found that, in

fact, the payments were not being made and the aged accounts payable reports were rapidly increasing.

Chairman ROTH. Did you ever see a genuine effort by Tampa Shipyards to turn things around and complete the ship?

Captain KLEIN. No, sir. We did see, as I mentioned in my statement, some three changes in top management of the company, but never did the company put in place the kind of structure, organization structure, or bring in the numbers of skilled craftsmen required to actually complete the job.

Chairman ROTH. Was the Navy correct in refusing Tampa's request for a $25 million bailout?

Captain KLEIN. Absolutely.

Chairman ROTH. I am sorry, I did not hear you.

Captain KLEIN. Absolutely, yes.

Chairman ROTH. Absolutely, no question about it?

Captain KLEIN. Not in my mind.

Chairman ROTH. Did the fiscal year 1993 Congressional appropriation awarded to Tampa Shipyards help complete the ships?

Captain KLEIN. No, sir. I mentioned that. I predicted at the time that we would not see any benefit from it, and, in fact, we did not. The company still went bankrupt and was terminated eventually.

Chairman ROTH. Was there not a pattern that, despite the number of steps the Navy took to help out, that nothing happened?

Captain KLEIN. Yes, sir. The Navy did, I think, a lot around the edges. There was no large change to the contract, but a lot around the edges to enable the company to get its own funds, right up until the time, as I mentioned, when I stopped progress payments, when I found them in violation of the P–00018 change, which required that they bring their accounts payable up current.

Chairman ROTH. I will turn to Senator McCain.

Senator MCCAIN. Thank you, Mr. Chairman, and I thank both the witnesses. Thank you for your service to our country and thank you for being here today.

Captain Schrodt, did you think that Penn Ship ever had a chance to complete these ships? The reason I ask that, Captain Klein had a very pessimistic view from the beginning. What was your view from the beginning?

Captain SCHRODT. I had the opportunity, sir, to come in 27 months after they started the contract, awarded the contract, so they had over 50 percent done on the first ship and started on the second, and, of course, the other two options had been awarded, so they had four ships in the contract.

New set of eyes took a hard look at it. Based purely on a technical basis without looking financially at it, and in 2 years, they had not had the sufficient, adequate managerial staff and core competencies in place to build those ships. Technically, we would not have achieved any ships, irrespective of the contract or irrespective of the yard. At this stage, the artisan skills required and the core competencies required to build a ship, I believe, in the Delaware Valley had already been diluted, had left, and you could not find the number of workers necessary to build a ship.

Senator MCCAIN. And when the decision was made to terminate, what role did you play in that decision?

Captain SCHRODT. I did not play a role in that. After my recommendation to Vice Admiral Rowdin, I made a couple more presentations to him and also to the Assistant Secretary of the Navy's staff, Secretary Pyatt. The decision in how it was terminated was done between the procuring contracting officer, NAVSEA, and then the top management of Penn Ship, and I was not party to that, sir. I was notified in March of 1988 that——

Senator MCCAIN. And you personally thought that was a good thing?

Captain SCHRODT. Yes, sir. The quicker, the better. In fact, I think the first two ships, sir, that were terminated, which no work had been done on but we sent the material South to Avondale, probably that termination took 8 months. It was probably quicker than the award took, I would guess.

Senator MCCAIN. Were you surprised when you heard that the two ships were going to be sent to Tampa?

Captain SCHRODT. No, sir. Or the first two ships?

Senator MCCAIN. Yes.

Captain SCHRODT. Yes, I was surprised, because I was in San Francisco at the time. Of course, Captain Klein was my counterpart in Jacksonville at that time, and I being on the West Coast in beautiful San Francisco, I could joke about what he got. It surprised me. I was even more surprised when I was called back here for testimony to find out, since I have not kept track of it, that we never got any ships. That really surprises me.

Senator MCCAIN. Had you just assumed, from your knowledge of what goes on in the Navy, that those ships would probably go to Avondale?

Captain SCHRODT. That would have been my decision, sir. If we could do the first two to Avondale, then we could dang well do the second two to Avondale.

Senator MCCAIN. Did you subscribe to this theory or idea about preservation of the industrial base extending to Penn Ship and to Tampa?

Captain SCHRODT. Once you pulled the first two ships, which were the last two ships of the contract, out of Penn Ship, which was in mid-1988, at that stage, you had decided that Penn Ship was not an industrial base because you de-loaded the shipyard. Therefore, they could not be an industrial base in the future. The top management of Penn Ship, at that time, talking to them, they were shopping around for other heavy industrial work not related to the marine industry, paper mill work, this type of thing.

Senator MCCAIN. Thank you, Captain.

Captain SCHRODT. Yes, sir.

Senator MCCAIN. Captain Klein, were you surprised, as Captain Schrodt sort of intimated, that you were going to get two ships down there in Tampa?

Captain KLEIN. Yes, sir, I was. To put it bluntly, I whined a lot to my superiors at NAVSEA. But, as I mentioned in my opening statement, at this point, the contract had already been awarded and there was no sense in crying about something that was a fait accompli, so we tried to see if we could not at least make it work from the beginning. But, no, I never had any illusion that Tampa Ship could finish the job.

Senator McCain. In response to a question that the Chairman asked, you said that the decision was made in the Secretary of the Navy's Office, outside of normal procedures. Did you know that for a fact?

Captain Klein. Certainly, outside of normal procedures, yes, sir. It had to go to the Secretary of the Navy's Office in order to get an industrial base decision.

Senator McCain. But it was clear to you that this decision was made outside of the normal procedures that are used by the Navy to select a shipyard to complete this work?

Captain Klein. Yes, sir.

Senator McCain. There was not a doubt in your mind?

Captain Klein. I have been involved in procuring, as well as administering, contracts, and procurement laws are very clear on how you solicit and how you award, and this was not done according to those routines of doing business.

Senator McCain. The only caveat that you could think of would be for reasons of preservation of defense industrial base?

Captain Klein. I could not support that at all. Tampa Shipyards would not help the industrial base in completing Navy contracts.

Senator McCain. But I am talking about the rationale that might be used in the decision making. In other words, a reason to go outside of the normal procedures would be, well, we have to do this because we have to preserve——

Captain Klein. That is why it had to go to the Secretary of the Navy's level. I do not think NAVSEA wanted to do it at all. I cannot answer for them.

Senator McCain. Which, obviously, does not coincide with the Secretary of the Navy's letter. I guess what I am saying, and I am not trying to ask you to comment on things outside of your pay grade, but, clearly, this was a very unusual kind of procedure that was gone through.

Captain Klein. Yes, sir.

Senator McCain. I would ask Captain Schrodt, as well, if you have ever been aware of this kind of unusual procedure in the awarding of a contract.

Captain Schrodt. No, sir.

Captain Klein. I am aware of it in years previous. I knew about that happened, particularly in the submarine world, nuclear submarines, where decisions were made to maintain the industrial base between only a couple yards that might be able to stay in business, but not for oilers, where lots of folks could make them.

Senator McCain. You also said, in response to a question from Senator Roth, that it was definite political influence, in your view.

Captain Klein. Yes, sir. I obtained that information, I have to admit, from the press. This story, down in Tampa and in Jacksonville, was much bigger than it is here. We are a little more naive, I suspect. But it got quite a run in the local papers about Congressional influence in the entire job, the entire award process. There were also a couple of articles written by a Mr. Nocera for Esquire Magazine, which had great fun with Mr. Steinbrenner.

Senator McCain. Did you ever, in conversations with the people that ran the shipyard, get this impression, also?

Captain KLEIN. No, sir. We did not talk politics down at our level.

Senator MCCAIN. You mention in your written statement, "In early June 1992, Congressmen Murtha and Young visited Tampa Shipyards along with Mr. Dan Howard," and then Gerald Cann, Assistant Secretary of the Navy, visited Tampa Shipyards, along with representatives of NAVSEA. It is not too unusual for Congressmen to visit a shipyard.

Captain KLEIN. No, sir, but in this case, those were the names, Congressmen Murtha and Young, that I had read about that had been involved in the original Tampa problem, the award of the contract. So when Tampa had requested the extraordinary relief under the 85–804 law, then to have these gentlemen show up all of a sudden was unusual. Nobody had seemed to take any interest in the shipyard up until then.

Senator MCCAIN. Was it unusual for Mr. Dan Howard, the Undersecretary of the Navy, and then Mr. Gerald Cann, to come down?

Captain KLEIN. Yes, sir, at their level. We had seen other folks from the Secretary's office come down. Mr. Kiss had come down a number of times. We also saw the Commanding Officer of the Naval Sea Systems Command. Admiral Heckman, for example, came down a number of times. But at the level of Mr. Howard and Mr. Cann, yes, that was unusual.

I think Mr. Cann was there as part of the decision making process for the Navy to decide whether or not the extraordinary relief would be granted. He came down and questioned my office extensively, had meetings with the contractor, and I could see clearly that the decision, not to grant the extraordinary relief, was made partly because of Mr. Cann's visit and the information he gathered on that visit.

Senator MCCAIN. Obviously, you kept up with this issue. Were you surprised when you learned that Congress appropriated $45 million to the shipyard?

Captain KLEIN. Yes, sir. I was shocked. I knew that Tampa Shipyards was trying to get Congressional action. I did not believe that they would do it.

Senator MCCAIN. Did you believe that it was anything that would be helpful to the shipyard or to the American taxpayer?

Captain KLEIN. No, sir.

Senator MCCAIN. Was not the Navy in litigation at that time with the shipyard?

Captain KLEIN. The shipyard had a number of claims outstanding. We were not in litigation per se, but there were claims which, I presume, would have been litigated, had we terminated.

Senator MCCAIN. But with your supervision of the program, you saw no justification for the American taxpayer to pay any money?

Captain KLEIN. No, sir. I thought that we had a strong position. I am not an attorney, but I thought we had a strong position in terms of our risk of having to pay the contractor additionally. He was about to default.

Senator MCCAIN. And it did not surprise you that the shipyard, despite that infusion, went bankrupt anyway?

Captain KLEIN. No, sir, it did not surprise me. I predicted it at the time.

Senator MCCAIN. You did?

Captain KLEIN. Yes, sir, in a formal report to NAVSEA.

Senator MCCAIN. Mr. Chairman, maybe we could have a copy of that report of Captain Klein's made a part of the record.[1] I think that would be helpful in compiling that record.

Chairman ROTH. Certainly.

Senator MCCAIN. Finally, Captain Klein, just to wrap up, what does it do to your esprit and professionalism and morale and that of the people that work for you, and I know there were a substantial number of people at that time, working on a project that, as you stated in your formal statement and in response to questions, you knew was going to fail? What impact does that have on you and the people in the military?

Captain KLEIN. It makes the job very hard. I do not want to get this across the wrong way, but I must take exception, Senator, to one thing that was in your opening statement. You asked the question, was anyone, I believe, or did no one look after the taxpayers' interest. I can introduce you to scores of people, at least on the local level, and I know of a number in NAVSEA that very definitely were looking after the Government's interest.

At one point in this process, in this whole sorry affair, I saw and my close associates at SUPSHIP Jacksonville saw that we were not going to get any ships. We decided then that we would take every precaution to ensure that at least the Government's interests were looked after as best we could, but we sort of gave up the idea that the ships were going to be produced and make sure that the Government's exposure was as limited as possible.

Senator MCCAIN. Is it the view of yours and Captain Schrodt's that if these two ships had been sent to Avondale, they would have been completed, admittedly, at significant cost overrun?

Captain SCHRODT. My view is if they were sent to Avondale, they would have been completed, yes, sir.

Captain KLEIN. I have only professional knowledge of Avondale, not close association, but, sure, based on their track record, they could have done it. Any competent shipyard could have done it.

Senator MCCAIN. Thank you very much, Mr. Chairman, and thank you for your testimony.

Chairman ROTH. Let me ask you this question on Avondale. Avondale, of course, is the shipyard that produced the other oilers. Did it make any sense to try to have an alternative contractor be available to produce these ships?

Captain SCHRODT. In my professional judgment, sir, based upon my knowledge of the shipbuilding base in the United States, there were other shipyards outside of Avondale, for example, maybe Nasco in San Diego, that would bid on them, and other shipyards that could bid them, so there were yards available to do that. But if not, we have only one yard that can build nuclear aircraft carriers and we get by, sir.

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[1] The document referred to was marked Exhibit No. 4, and can be found in the files of the Subcommittee.

Chairman ROTH. Let me clarify the one statement, because I want to make it clear that I very strongly agree that there were many in the Navy who were protecting the taxpayers' interest. My concern is that the system is such that, at the end of the day, you cannot point your finger at anyone. And if he or she does a good job, how do you give him or her credit, as the case may be?

It seems to me that we need to introduce some accountability into the system so that we provide incentives for people to do a good job and they be awarded for doing a good job. What concerns me here is that there were so many different people involved, whom do you blame?

Gentlemen, I want to thank both of you for your very, very helpful testimony. We may have additional questions as we proceed. But again, I want to say, if your advice had been followed earlier, we all would have been a lot better off, and probably had completed ships at a much lower cost. Thank you very much for your help.

Captain SCHRODT. Thank you.

Captain KLEIN. Thank you, sir.

Chairman ROTH. The Subcommittee is in recess.

[Whereupon, at 2:40 p.m., the Subcommittee was adjourned.]

NAVY T–AO 187 KAISER CLASS OILER CONTRACTS

THURSDAY, MAY 4, 1995

U.S. SENATE,
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS,
OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:02 a.m., in room 342, Dirksen Senate Office Building, Hon. William V. Roth, Jr., Chairman of the Subcommittee, presiding.

Senators Present: Senators Roth, Thompson, Grassley, McCain, and Nunn.

Staff Present: Harold Damelin, Chief Counsel and Staff Director; Eric Thorson, Chief Investigator; Carla J. Martin, Chief Clerk; Stephen H. Levin, Counsel; Christopher Greer, Investigator; Mary Ailes, Staff Assistant; Michael Bopp, Counsel; John H. Cobb, Counsel; Sue Horner, Librarian, Daniel S. Gelber, Chief Counsel to the Minority; Mary D. Robertson, Assistant Chief Clerk to the Minority; Scott Newton, Minority Investigator; Ginny Koops (Senator Roth); Sy Hyland (Governmental Affairs); Claudia McMurray (Senator Thompson); Brian Dettelbach (Senator Glenn); Dale Cabiness (Senator Stevens); Charlie Murphy (Senator Grassley) and Mark Buse (Senator McCain).

OPENING STATEMENT OF CHAIRMAN ROTH

Chairman ROTH. The Subcommittee will please come to order.

This morning we will continue our hearing on the Navy T–AO Kaiser Class oiler contract.

Let me start out by saying that at 12:15 p.m., there will be a series of votes on the Senate floor. So we will recess for an hour between 12:15 and 1:15 p.m. to permit the Members to go down and vote. If it extends beyond that, obviously we will not continue this hearing until the end of the series of votes.

On Tuesday, we heard from the Defense Department's Deputy Inspector General. He presented a compelling case of incredible mismanagement and ineptitude by all parties involved in this contract, resulting in the waste of $450 million, roughly, for which we, and by that I mean the taxpayers, received no completed ships.

The contract was originally awarded in 1985 to Penn Ship. Penn Ship was, at best and by any standard, only marginally qualified to build these ships. Throughout the 4 years prior to Penn Ship's contract being terminated for default, this project deteriorated into an abyss of misplaced optimism, indefensible decisions, and gross mismanagement.

After paying Penn Ship more than $300 million, the Navy jumped from the frying pan into the fire. Inexplicably, the Navy awarded the contract to complete these ships to Tampa Shipyard, who even the Navy's own supervisor of shipbuilding said could not do the job. This contract was also plagued with mismanagement, cost overruns, and unpaid subcontractors and vendors.

Unfortunately, this is not the end of the story. Despite not performing under the contract, Tampa asked the Navy for more money. The good news is that the Navy finally decided to stop throwing good money after bad and denied Tampa's request. The bad news is that Tampa found its white knight when Congress provided the company with a bailout.

There is also a final straw to this story. Despite already paying more than $400 million for these two rusting hulks, last month the Government agreed to pay Tampa another $18 million to settle a case it filed against the Government.

Today we will first hear from the contractors, Penn Ship and Tampa Shipyards, and then from representatives of the U.S. Navy. We look forward to hearing, from their perspective, how we arrived at this point with $450 million in taxpayers' money invested in two unfinished ships that originally should have cost less than half that amount.

Regarding Tampa Shipyards, George Steinbrenner, the company's acting chairman during the period of the oiler contract, was subpoenaed to appear before the Subcommittee and testify here today. However, due to a medical condition that has restricted his ability to travel, Mr. Steinbrenner has been granted a continuance of that subpoena so as not to delay these hearings. Mr. Steinbrenner has agreed to appear before the Subcommittee and testify under oath regarding this oiler contract, if and when the Subcommittee demands or deems his testimony to be necessary. The Subcommittee has agreed to the appearance and testimony today of William R. Boyles, Jr., vice president of Finance for Tampa Shipyards, since we understand Mr. Boyles is fully prepared, based on his position and experience, to address the financial details of the contract.

In conclusion, I believe this oiler contract serves as an expensive case study highlighting a multitude of problems that currently exist within our Nation's defense procurement system. This oiler contract illustrates the lack of accountability and efficiency in our current military procurement system. This illustrates how much harder and more expensive it is to try and correct a contract that is fundamentally flawed from the outset, and this contract illustrates that it is essential that we promote qualitative, as well as quantitative, judgments by our experienced personnel in the field. This should be an integral part of the procurement award process.

As these hearings show, our procurement system is in dire need of reform. I believe we need to adopt a common sense approach to procurement. We need to promote efficiency and eliminate the bureaucratic mind-set. We need to provide accountability by giving managers and contractors incentives to deliver their programs on time and on budget.

I think we can learn a great deal from the way in which retired Navy Captains Pete Schrodt and Karl Klein carried out their re-

sponsibilities for this contract as supervisors of shipbuilding at Penn Ship and Tampa Shipyards, respectively.

Captain Schrodt told us in his testimony on Tuesday that he repeatedly recommended to his superiors that they terminate this contract, and in his testimony, Captain Klein noted that, contrary to what was being said about the contract, there were many people in the Government who were looking out for the taxpayers' interest.

I want to emphasize that he was one of them, sending "bell-ringer" reports to his superiors advising them that Tampa Shipyards could not complete these ships. The point is that, often, the problem isn't in the field; it is in Washington. Those at the top just don't get the message. That must change. We cannot salvage these two oiler ships, but we can salvage the system.

PREPARED STATEMENT OF SENATOR ROTH

This morning we will continue our hearing on the Navy T–AO Kaiser Class oiler contract. On Tuesday, we heard from the Defense Department's Deputy Inspector General. He presented a compelling case of incredible mismanagement and ineptitude by all parties involved in this contract, resulting in the waste of $450 million for which we, and by that I mean the taxpayers, got no ships.

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After paying Penn Ship more than $300 million, the Navy jumped from the frying pan into the fire. Inexplicably, the Navy awarded the contract to complete these ships to Tampa Shipyard, who even the Navy's own Supervisor of Shipbuilding said could not do the job. This contract was also plagued with mismanagement, cost overruns, and unpaid subcontractors and vendors.

Unfortunately, this is not the end of the story. Despite not performing under the contract, Tampa asked the Navy for more money. The good news is that the Navy finally decided to stop throwing good money after bad and denied Tampa's request. The bad news is that Tampa found its white knight when Congress provided the company with a bail-out.

There is also a final straw to this fiasco. Despite already paying more than $400 million for these two rusting hulks, last month the Government agreed to pay Tampa another $18 million to settle this case.

Today we will hear first from the contractors—Penn Ship and Tampa Shipyards—and then from representatives of the U.S. Navy. We look forward to hearing, from their perspective, how we arrived at this point today—with $450 million in taxpayers' money invested in two unfinished ships that originally should have cost less than half that amount.

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As these hearings show, our procurement system is in dire need of reform. I believe we need to adopt a common sense approach to procurement. We need to promote efficiency and eliminate the bureaucratic mind-set. We need to provide accountability by giving managers and contractors incentives to deliver their programs on time and on budget.

I think we can learn a great deal from the way in which retired Navy Captains Pete Schrodt and Karl Klein carried out their responsibilities for this contract as Supervisors of Shipbuilding at Penn Ship and Tampa Shipyards, respectively. Captain Schrodt told us in his testimony on Tuesday that he repeatedly recommended to his superiors that they terminate this contract. And in his testimony, Captain Klein noted that, contrary to what was being said about the contract, there were many people in the Government who were looking out for the taxpayers' interest. I want to emphasize that he was one of them—sending "bellringer" reports to his superiors advising them that Tampa Shipyards could not complete these ships. The point is that, often, the problem isn't in the field—it is in Washington. Those at the top just don't get the message. That must change. We cannot salvage these two oiler ships. We can salvage the system.

Chairman ROTH. Senator Grassley.

Senator GRASSLEY. First off, Mr. Chairman, thank you for holding these very important meetings. You have been a leader for this area for well over a decade. I thank you again.

I also feel like I need to make an apology to the Subcommittee for not being here on Tuesday, because I had to chair our Judiciary Subcommittee meeting.

There really is nothing more important than digging into the waste and mismanagement of the tax dollars because money taken out of the pockets of hard-working American citizens is being wasted. It has to be spent wisely and according to law, and at the very least, I want to emphasize spent according to the law.

I think you see spending on the Navy oilers as something that is pure and total waste. We see big bucks going out the door, but we have nothing, absolutely nothing, to show for it. It is waste like this that is sapping our military strength.

If Pentagon bureaucrats were not wasting so much money, the $270 million a year that we spend on defense would be more than enough to keep our military modern and to keep it ready. We have flagrant waste and mismanagement, and it is straining away precious financial resources.

In this particular case, $450 million was set aside in the Navy budget to help modernize the Navy's fleet of surface ships, and all of it was wasted, 100 percent wasted. The Pentagon poured $450 million down a rat hole, as far as I can see. They spent $450 million and have absolutely nothing to show for it except two rusting hulks that are moored at the James River in Virginia. These two unfinished ships are obviously going to be good for nothing but scrap. They will never see one single day of useful Naval service.

Mr. Chairman, this, I know to you, is very disgusting, but more importantly, it has got to be stopped by a Congress now which is very concerned about balancing the budget by year 2002. It is totally unacceptable and must not be tolerated in the future.

The Navy oiler contract is not, of course, an isolated case. I recently looked at the Advanced Cruise Missile, and I found in this program exactly the same thing. I found at least—I say at least—$300 million worth of unfinished ACM missiles left for scrap in a San Diego plant. Also, this was strictly because of mismanagement. Unqualified waste on the Navy oilers or the ACM together amount to nearly $1 billion.

Those responsible for such waste must be held accountable if we are ever going to put an end to this. Mr. Chairman, that is not going to happen, though, unless we demand that it happen. We know that no punishment has been meted out for the Navy oil fiasco. No disciplinary action has been taken, not even the usual slap on the wrist or a reprimand.

My worst fear following some other examples I have investigated is that those involved might even be rewarded with promotions and cash bonuses.

We know that at least one person directly involved has already been promoted. We need to know if any others have also been rewarded.

Mr. Chairman, you and your very able assistant, Mr. Thorson, have done an excellent job investigating this matter. You have laid all the pertinent facts before the Subcommittee. Now it is up to us to act on this information in a very responsible way.

I think we need to work with the Inspector General and the Department to fix responsibility wherever it belongs, no matter how high up the chain of command it might go. We must hold appropriate officials responsible for what happened. We need to pinpoint responsibility for all improper decisions on the Navy oiler ship contracts because we tend to blame the process, but the acquisition process didn't do it.

A process doesn't make irresponsible decisions. People make irresponsible decisions, and we need to know who those people are. The people of this country desperately want to trust their Government and make sure that there are wise decisions made, and when those wise decisions aren't made that people are held accountable for that. A Government that doesn't hold corrupt officials accountable will, of course, lose public trust. A failure to hold dishonest officials accountable breeds mistrust. It invites more waste. So Congress has a moral responsibility to hold people accountable, particularly for fraud, but also as much for waste and mismanagement.

I have been told that there is some GS–15 contracting officer by the name of Harold Hanson who bears some responsibility. Well, that may be fine and dandy that there is somebody at the GS–15 level, but these people don't make major decisions in major shipbuilding contracts or any Department of Defense decisions. Those kinds of decisions are made higher up the chain of command, in the Navy Sea Systems Command or at the Navy Secretariat.

Mr. Vander Schaaf suggested at Tuesday's hearing that the General Counsel in the Navy Sea Systems Command and the Assistant Secretary of Navy for Shipbuilding may also bear some responsibility for the improper decisions. We need to find out, then, Mr. Chairman, who is responsible for what happened.

I would like to make this recommendation to the Subcommittee, and then I will stop. I would like the Subcommittee to write a letter to the Department of Defense IG, Ms. Eleanor Hill, instructing her to fix responsibility for the Navy oiler ship contract fiasco, and to recommend disciplinary action, if appropriate. The IG has ample authority in law, that is the Inspector General Act of 1978, to fix responsibility for gross waste and abuse and to recommend corrective action, including disciplinary action.

I also would like to know if any of those officials have been recommended for promotion or cash bonus awards since the oiler contract was awarded. I would be happy to join you in signing such a letter.

So, Mr. Chairman, could you please give me some advice and guidance on how we might consider handling such a letter or any other recommendation you might have, if there is another process you would like to use, to see if we can get to the bottom of who is responsible, so that we set an example and let others know that for such waste of the taxpayers' money, somebody must be held responsible and not just try to hold the process responsible.

Chairman ROTH. Thank you, Senator Grassley.

As I have said both today and in the earlier meeting, accountability is the critical question, I think, addressed by this hearing. As to what action we shall take, I think it will be determined by the completion of the hearings.

At this time, I would like to call upon my distinguished colleague and Ranking Member, Senator Nunn.

Senator NUNN. Mr. Chairman, I have already made an opening statement at the first hearing, and I again congratulate you and your staff. It has been a pleasure working with you on this important case.

I think the question of accountability in military procurement is enormously important, and I certainly hope that we can lay out the facts in this case, so that we begin to get a grasp of who was accountable, how the decisions were made, and what was behind the errors that were made that cost so much money.

Chairman ROTH. Thank you, Senator Nunn.

Senator Thompson.

Senator THOMPSON. I have no opening statement.

Chairman ROTH. Senator McCain.

OPENING STATEMENT OF SENATOR McCAIN

Senator MCCAIN. Mr. Chairman, just very briefly, I share the zeal and dedication of all Members here and, indeed, all Americans to attempt to find who is culpable in this disastrous waste of $400 million of the taxpayers' money.

Inasmuch, the regard in which I hold the IG of the Department of Defense, I was very disappointed at his responses to your and my questions about who was responsible, and basically his answer was no one is responsible. Clearly, that is not the case.

I also think there is another factor that I have to say in all candor, Mr. Chairman, that I hope we will pursue with equal zeal. That is the issue of congressional influence in this process.

There have been allegations of congressional interference. What is it that drove the decision? Was congressional influence present in determining the decision to send these two oilers to Tampa when there was a perfectly well-qualified and legitimate shipyard that everyone knew could do the job?

The project manager, Captain Klein, said he was astounded when he heard that the project was being sent to Tampa. What is it that influenced the Appropriations Committee to put in a $45 million bailout for this shipyard at a time when the U.S. Navy was

adamantly confident, totally confident that the Tampa Shipyards had no legitimate claim against them?

What was it in the appropriations process, without a hearing, without any facts laid before the Congress and the American people that a $45 million bailout was inserted into the 1993 Appropriations Bill?

So I hope we will pursue with zeal culpability in the Pentagon. I hope we will pursue with zeal a process in the Congress of the United States that causes a $45 million bailout to appear in an Appropriations Bill that, as far as this Member is concerned, had no rhyme or reason associated with it. I might add, not only did it not have any purpose, the shipyard went bankrupt, anyway, which is a matter of record.

I thank the Chairman, and I thank the witnesses for appearing here today.

PREPARED STATEMENT OF SENATOR MCCAIN

Mr. Chairman, I want to thank you for holding this hearing. This is a matter on which we should have held hearings some time ago.

Mr. Chairman, every taxpayer in this country has a right to be outraged by the money we wasted on two unfinished oiler ships. The Government spent over $400 million to procure what are now two rusting hulls sitting in the James River. A full understanding of the history of this matter is enough to make a strong person sick.

There is plenty of blame to share, and I hope this committee will fairly and forthrightly bring forward the facts before it assigns blame to any one party.

The problem here is much more than the Navy's misjudging two contractors. It is much more than a failure of two contractors to fulfill their obligations. The problem here is one of Congressional micromanagement and influence that led to the outright waste of over $400 million dollars.

I believe that the facts show that both the Navy and the original contractor had good intentions. Those intentions were never fulfilled and the procurement of two oiler ships from Penn Ship—which defaulted on its obligations—was unsuccessful. Penn Ship deserves blame for its failure to complete its contractual obligations.

Clearly, however, the contract for the completion of the two ships should never have gone to the Tampa Shipyards. The Tampa Shipyards were in even worse financial shape than the Penn Ship company. Further, the Tampa shipyards were woefully unqualified to complete the work assigned to it. Tampa was primarily a ship repair yard—not a yard designed to build new ships. a project as large and complex as the completion of oilers 191 and 192 had never been undertaken there.

Yes, the Navy deserves some blame for contracting work to a company unqualified to complete the assigned projects. But I must point out that this case is different from some cases investigated in the past. We have all heard about the $100 screwdriver and the $500 toilet seats. Those expenditures were wrong and those responsible deserved our reprimand for wasting the taxpayers' hard earned money. But this case extends beyond the Navy. If the bulk of the blame should be placed anywhere, it should be placed right here, squarely on the shoulders of the Congress.

An extremely disturbing theme evident throughout this entire matter is how alleged Congressional influence affected the decision making process. It is alleged that Congressional influence that practically forced the Navy to give its contract to the Tampa Shipyards and it is clear that the Congress eventually resulted in an earmark in the Department of Defense Appropriations bill that overruled a Navy decision, and bailed out an extremely wealthy individual.

On December 13, 1988, Secretary of the Navy, William Ball wrote to Congress that the closure of three shipyards, Penn Ship, Bethlehem Steel, and Tampa Shipyards would have only a minimal impact on industrial base preservation, and that payment of any premiums for contract to keep any of those yards open was not justified.

Yet, the Congress, through alleged pressure exerted on the Navy, and later through legislative earmarking, did exactly the opposite. What became clear is that a few well connected lobbyists prevailed over the collective expertise of the Navy and many other ship building experts, all of whom thought that Tampa was not qualified to finish these ships.

The Congress in the DoD FY 1993 Appropriations Act appropriated $45 million for the oiler ship contract and $13.3 million for crane ship contract that Tampa was assigned. It was the Congress who bailed out George Steinbrenner to the tune of $58 million dollars.

That is the real story. That is the story that needs to be brought to light. And that is the story I hope this Committee will investigate.

Chairman ROTH. Our first witnesses today are former officials of the Pennsylvania Shipbuilding Company, also referred to as Penn Ship. Thomas C. Weller, Jr., is the former chief executive officer, and Ronald J. Stevens is the former president of Penn Ship.

We swear in all witnesses who appear before the Subcommittee. So please rise and raise your right hand.

[Witnesses sworn.]

Chairman ROTH. Please be seated, gentlemen. You are accompanied by counsel. Would you please introduce who the counsel are.

Mr. WELLER. Mr. Chairman, this is Mike Dyer with the law firm of Dyer, Ellis, Joseph and Mills, and this is Mr. Bennett of Skadden, Arps, and Mr. Carl Rauh of Skadden, Arps.

Chairman ROTH. Mr. Weller, I assume that you are the one who is going to testify. Please proceed.

Mr. WELLER. Yes, sir. Mr. Stevens is going to make our opening comments, Mr. Chairman.

Chairman ROTH. OK. Mr. Stevens.

TESTIMONY OF RONALD J. STEVENS,[1] FORMER PRESIDENT, PENNSYLVANIA SHIPBUILDING COMPANY, AND THOMAS C. WELLER, JR., FORMER CHIEF EXECUTIVE OFFICER, PENNSYLVANIA SHIPBUILDING COMPANY; ACCOMPANIED BY ROBERT S. BENNETT, ESQ., SKADDEN, ARPS, SLATE, MEAGHER AND FLOM; AND THOMAS M. DYER, ESQ., DYER, ELLIS, JOSEPH AND MILLS

Mr. STEVENS. Good morning, Mr. Chairman and Members of the Subcommittee.

My name is Ronald J. Stevens. I am the current president of City Capital Corporation, which is the successor company to Pennsylvania Shipbuilding Company where I was president from 1985 until 1993. Before that, I was an executive for about 10 years with the Weller Company, which is an industrial real estate company in Mobile, AL. Prior to that experience, I was employed by Rust Engineering Company for about 8 years, where I eventually rose to senior-level management in that company. Rust is one of the largest industrial engineering and construction companies in the country and is particularly skilled in the design and construction of paper mills.

Mr. Chairman and Members of the Subcommittee, we appreciate the opportunity to appear before you today and tell our side of this matter.

While we have forwarded to each Member of the Subcommittee a set of highly relevant materials, including our full statement, we welcome this opportunity to summarize that statement and to correct some inaccurate assertions made earlier in these proceedings.

At the outset, we want to emphasize that Penn Ship was qualified to build these ships, and we wish that Penn Ship had been al-

[1] The prepared statement of Mr. Stevens appears in the appendix on page 143.

lowed to complete the T–AO's that it contracted to build for the Navy. What is unfortunate is that with a little more assistance from the Navy at a crucial point in this contract, all the vessels would have been completed.

As it was, two vessels were completed entirely at Avondale Industries in New Orleans, and the two vessels remaining at Penn Ship, T–AO 191 and 192, were delivered to the Navy in good condition and were 91 percent and 74 percent complete, respectively.

Had we been given a minimum of financial assistance, an amount far less than what was given to Tampa, or had the ships been delivered to Avondale, they would be in the fleet today. This was not permitted by the Navy.

Nevertheless, Penn Ship worked with the Navy to develop a solution, the transfer of these two ships to Avondale, to ensure that all four vessels would have been completed without any increase in the Navy's contractual liability. Also, it must be noted that we resolved all outstanding liabilities with the Navy.

We respectfully submit that the death of these healthy ships was caused by the fatal decision to transfer them to Tampa. The decision was illogical and contrary to good procurement practice.

We have prepared a full statement which I will not read, but ask that it be made part of the record as a hearing exhibit.

Further, we request that the following documents also be made part of the record. These include factual corrections to the DoD IG report, which is seriously in error in both facts and conclusions, and affidavits of William T. Gallagher, William H. Martin, and John J. Lawler, three former Penn Ship employees who were directly involved in these vessels.[1]

After leaving Penn Ship, two of these individuals were employed by Tampa Shipyards on the T–AO contract. William T. Gallagher, who was executive vice president and general manager at Penn Ship from 1987 through the close of the year in 1989, was hired by Tampa Shipyards as vice president of New Construction to supervise the T–AO contract. He is presently the program manager of a 10-vessel Canadian Navy Combatant Program at St. John's.

John Lawler, who was a long-time manager in Penn Ship's Engineering Department, was hired by Tampa Shipyards as project engineer for the T–AO program.

William H. Martin, a Penn Ship superintendent on the T–AO project, declined to accept employment at Tampa after visiting the facilities and meeting with the shipyard personnel.

The collective gist of these affidavits is that Penn Ship was fully capable of completing the vessels; that the decision to take the vessels from Penn Ship was wrong; that the workmanship and condition of the vessels at the time they left Penn Ship was good and, in many respects, exceeded applicable standards; that the decision to transfer the vessels to Tampa Shipyards was a serious mistake; that Tampa Shipyards was essentially a repair yard and did not have the infrastructure, experience, expertise, facilities or work force to handle a contract of T–AO's magnitude.

[1] The documents referred to was marked Exhibit No. 5, 6, 7 and 8, and can be found in the files of the Subcommittee.

We would now like to address certain allegations directed at Penn Ship during Tuesday's hearing, all of which we thought we had successfully addressed with the Subcommittee staff prior to this hearing, but because they have been raised again in this hearing, we believe it would be helpful if we could respond to those issues at the outset.

No. 1, it has been asserted that Penn Ship was not technically competent and that it had not constructed a major vessel during the previous decade. This is not accurate.

During its 70-year history, this shipyard under various owners designed and constructed over 650 vessels. In the years leading up to the award of the T–AO tanker contract, it was primarily building commercial tankers and complex commercial roll-on/roll-off cargo vessels, delivering the last three in the early 1980s.

In addition, this shipyard successfully completed the complex conversion of two commercial vessels to sealift vessels for the Navy at the time the T–AO program was being solicited.

In the years just preceding the sale of this shipyard in 1982, its then-owner, Sun Oil Company, invested over $100 million in facility modernization and improvements. This shipyard was fully capable of constructing new vessels as it had throughout its history.

Penn Ship could have finished building the ships with a modest amount of additional money and the cooperation of the Navy, which was the Navy's approach on similarly situated other contractors.

This view is supported by the conclusion reached in a February 1988 independent assessment by Advanced Technology, now called PRC, which was retained by Penn Ship to review its T–AO program. Advanced Technology is the same consultant used by the Navy to review its Destroyer Program. The Advanced Technology team was led by Rear Admiral William Wyatt, U.S. Navy (Retired), and included among other retired Navy officers, Vice Admiral Russ Bryan, former head of the Naval Sea Systems Command.

Their conclusion was itself confirmed by the fact that the company had completed 91 percent of T–AO 191 when the Navy decided to terminate the program at Penn Ship. All of this work was approved and certified where required by the American Bureau of Shipping, which is the agency responsible for certifying the ships to be built to commercial standards.

No. 2, it has been asserted that Penn Ship's bid was a "buy-in." This is not accurate. Penn Ship's bid was carefully prepared by experienced estimators who were supervised by very experienced senior managers, including Rear Admiral Charles Payne, the president of Penn Ship at the time, and formerly the Commanding Officer of the Charleston Naval Shipyard, Comptroller of the Naval Sea Systems Command and SUPSHIPs at Ingalls in Pascagoula.

Penn Ship did not believe its bid, which was based on reasonable assumptions, was incapable of performance. On bid evaluation, the Navy determined the Penn Ship bid to be "within the competitive range," meaning it was realistic, neither too high nor too low.

Penn Ship's average price per ship for its oilers was within 4 percent of the average price per ship for the three T–AO's in this flight that was awarded to Avondale Industries.

The failure of certain of Penn Ship's bid assumptions to materialize was due, in part, to poor Navy SUPSHIP contract administration and, in part, to other causes outside of Penn Ship's control.

Penn Ship's bid proposal was not set below "anticipated cost" nor was this bid submitted with the "expectation of increasing the contract price after award," which is the definition of a buy-in used by the DoD IG. In fact, the final contract liability of the Navy was never increased throughout the term of its contract at Penn Ship.

No. 3, it has been asserted that the trust indenture was a "worthless document" due to the failure to file. This is not accurate.

First of all, the trust indenture itself is not a recordable document. The underlying mortgage and security instruments are recordable, but even though they were not recorded for public record, the trust documents were executed, and in accordance with its terms, the Navy had a subordinate secured position in $20 million worth of Penn Ship assets throughout the existence of the trust indenture, and at the end of the day, the Navy obtained the full benefit of the security it had negotiated under the trust indenture. The maximum assets the Navy could obtain under the terms of the trust indenture itself was $20 million.

It was already noted in Tuesday's testimony, the Navy acquired Penn Ship drydock No. 4, valued by independent appraisers at $19 million, and agreed to other considerations in full settlement of Penn Ship's liability.

No. 4, it has been asserted that $108 million was added to the Penn Ship contract. This is not accurate. At no time during the T–AO contract with Penn Ship did the Navy ever increase its financial liability over the level at contract award. In spite of claims to the contrary, the June 16, 1988, modification No. 5 to the T–AO contract did not increase the Government's liability. In fact, modification No. 5 converted the four-ship contract from an original ceiling price of $489.8 million which was calculated in 1984 dollars, not including inflation and not including changes, to a negotiated firm fixed price of $558 million, which did include escalation and contract changes.

The new, all-inclusive, firm fixed price for four ships simply reflects the original ceiling price, plus changes that had been incorporated, plus escalation paid to date, and estimated future escalation, all of which are part of the Navy's original financial liability.

Penn Ship and Avondale then negotiated the price of the two T–AO's transferred to Avondale, T–AO 194 and 196, and Penn Ship received the balance of the price for T–AO 191 and 192. Of this total amount, Penn Ship was to receive $331.4 million.

On this issue, the Navy's response to the DoD IG report stated the following: "The report concludes that the contract price was raised by $108.9 million. It is extremely misleading, as it does not discuss the fact that the ultimate liability was never increased. In fact, the Government's liability for four ships included escalation, target-to-ceiling spread, and a number of changes to the contract. See DoD IG report, page 45."

Thus, the Navy's position was that its financial responsibilities on the four-ship contract were not increased at all. Any notion that the Navy's liability was increased simply reflects a lack of under-

standing of fixed price incentive fee contracts and fails to take into account that the original contract pricing also allowed for escalation payments for inflation.

No. 5, it has been asserted that Penn Ship owed the Navy $100 million at contract termination. This is not accurate. At termination, Penn Ship's reprocurement liability to the Navy was $26 million, which was based on transferring the vessels to Avondale for completion. At the same time, Penn Ship had substantial claims under the T–AO contract and five other Navy contracts. All these issues were settled with the transfer of the $19 million drydock, covered by the trust indenture, a $2 million credit for certain Penn Ship claims on some of its repair contracts, Penn Ship's release of its other claims on these contracts, and a contingent liability expressed in an excess cash flow formula under the settlement agreement.

No. 6, Captain Schrodt, former head of SUPSHIP at Penn Ship, asserted on Tuesday that at termination, the two vessels were approximately 80 percent and 60 percent complete, respectively. This is inaccurate.

I would call to your attention that the vessels' physical progress is well documented in the Navy SUPSHIP-approved progress billings submitted every 2 weeks during construction. SUPSHIP reviewed and approved the progress on each of the vessels.

The May 9, 1989, SUPSHIP-approved progress invoices stated the vessels were 91 percent and 74 percent complete. These approvals are being submitted by us for the record as hearing exhibits. This work was also certified and inspected, where required, by ABS.

No. 7, it has been asserted that the Navy paid Penn Ship $45,000 per day to "watch the ships" after the contract was terminated and paid this sum even after the ships were towed away. This is not accurate. Under the termination agreement signed in August 1989, Penn Ship had agreed to perform the work associated with preparing the ships for sea tow, inventorying, packaging, and loading all the remaining materials, equipment, and supplies, and this effort involved preparing over 500 to 600 tractor-trailer loads of material, two seagoing barges of material, and preparation of the ships for tow to the completion contractor designated by the Navy.

Under the terms of the termination settlement agreement, this work was to take place within a 12-week period immediately following contract termination. The settlement also provided that if there was a delay by the Navy in selecting its completion shipyard, the commencement of this enormous amount of work required to prepare and transfer the vessels and all of their equipment and incomplete structural units and other materials would be delayed.

The Navy agreed to pay Penn Ship $45,000 per day to keep all of the shipyard facilities and labor force, which as I recall was approximately 300 to 400 employees, available to perform this work and to preserve and protect its ships.

It should be remembered that at this time, there was essentially no work in the shipyard and, thus, no other reason to keep the shipyard open except for the benefit of the Navy to effect the departure of these vessels.

As it developed, the Navy delayed the decision selecting the new shipyard by over 3 months, which was most surprising as everyone had anticipated these vessels would be taken immediately to Avondale Industries in New Orleans, the shipyard building the other T–AO's.

If the Navy had designated the completion contractor when the termination agreement was signed, there would have been no delay cost to the Navy. We wonder why when it appeared all but certain that the ships were going to Avondale that it took the Navy 100 extra days to tell us that the ships were going to Tampa.

The true debacle that occurred here did not begin until the vessels were towed out of Penn Ship. The Navy could have had these ships completed at Penn Ship or, alternatively, at Avondale. As we stated earlier, the death of these healthy ships was caused by the fatal decision to transfer them to Tampa.

We are gratified to have this opportunity to present to the Subcommittee our side of the story and to tell you here today that at all times we have acted honorably in our dealings with the Government.

Thank you, Mr. Chairman.

Chairman ROTH. Thank you, Mr. Stevens.

Mr. Stevens, in your statement you talk about the history of the Penn Ship shipyard and the fact that in its 70-year history it produced over 650 ships. How many new ships were built at the yard since the time of your involvement?

Mr. STEVENS. The only new ships that we were involved with were the T–AO's, sir.

Chairman ROTH. So the answer is no ships.

Mr. STEVENS. None were completed. No, sir.

Chairman ROTH. Prior to the award of the contract, isn't it true that the Navy expressed concerns regarding Penn Ship's financial condition?

Mr. STEVENS. I think in the pre-award survey, sir, they did investigate Penn Ship's financial condition extensively.

Chairman ROTH. Did they not express some concern?

Mr. STEVENS. Yes, they did, sir.

Chairman ROTH. Is it correct that Penn Ship represented to the Navy, prior to the award of the contract, that the company was not obligated for any debts of its parents, Capital Marine Corporation, or any of its parents' other subsidiaries?

Mr. STEVENS. I was not directly involved in those conversations, sir, but as I recollect, in a memorandum that was reviewed that Mr. Piggott had wrote, there was some comment to the effect that the company did not have any such obligations.

Chairman ROTH. Mr. Stevens, I show you two documents. They should also be shown to Mr. Weller. I show you two documents dated as of December 31, 1984, both entitled "Guaranty."[1] These documents state that Penn Ship is a guarantor of its parent, Capital Marine Corporation, in the amount of $4.2 million, and, Mr. Weller, it appeared to be signed by you. Did you ever inform the Navy about these obligations of Penn Ship?

[1] The document referred to was marked Exhibit No. 17, and appears on page 227.

Mr. WELLER. Mr. Chairman, that was a long time ago. I truly don't recall what conversations I had with the Navy about these guaranties, and I don't recall Penn Ship making a statement that Penn Ship would never make a guaranty, or anyone else. I just don't recall that. This happened over 10 years ago.

Chairman ROTH. But that is your signature?

Mr. WELLER. Sir.

Chairman ROTH. Do those two documents contain your signature?

Mr. WELLER. It looks like my signature, yes, sir.

I want to point out that I believe these were signed as of December 31, but they were signed in August of 1985.

Chairman ROTH. Now, Mr. Weller, as I understand it, this represents unpaid insurance premiums. Isn't it true that prior to the award of the contract, you knew these two insurance companies would require a note from Capital Marine Corporation and a guaranty from Penn Ship to satisfy the debt?

Mr. WELLER. Mr. Chairman, I really can't recall what happened during that period of time with reference to these guaranties and notes.

Chairman ROTH. Let me ask you this. In light of the Navy's concern about Penn Ship's financial condition, wouldn't it have been appropriate for you to inform the Navy of this obligation whenever it was incurred?

Mr. WELLER. Mr. Chairman, if my memory serves me right, these obligations were already on the books of the company because they represented worker's comp obligations, worker's comp insurance obligations.

Chairman ROTH. Well, Mr. Weller, even assuming that you didn't sign the guaranties until August 1985, there is no reference to the guaranties in the 1985 Penn Ship financial statement, and in fact, there is no reference to it in the 1986 Penn Ship financial statement.

The first time that the guaranties appear in the Penn Ship financial statement is for the year ending September 30, 1987.

Shouldn't this obligation have been disclosed in the 1985 and 1986 financial statements of the contingent liability?

Mr. WELLER. Mr. Chairman, as far as I know, they could have been, but I really have not reviewed those statements. So I can't make a comment on them.

Chairman ROTH. I would like you to review these documents and give us your answer in writing.

[The information follows:]

EXHIBIT A

1. Penn Ship's obligation for Employers Casualty past due insurance premium note executed by Capital Marine in August, 1985 and guaranteed by Penn Ship.

Committee's question: Chairman Roth: "Mr. Weller, even assuming that you didn't sign the guarantees until August 1985, there is no reference to the guarantees in the 1985 Penn Ship financial statement; in fact, there is no reference to it in the 1986 Penn Ship financial statement.

The first time that the guarantees appear in the Penn Ship financial statement is for the year ending September 30th, 1987.

Shouldn't this obligation have been disclosed in the 1985 and 1986 financial statements of a contingent liability?"

Penn Ship's response: Penn Ship's contingent liability in the form of a guaranty of an obligation with its parent company should have been disclosed in a footnote under the "Commitments and Contingencies" section in the Penn Ship audited statements for 1985 and 1986. The company has no recollection as to why or how this was overlooked by its auditors.

Mr. WELLER. Yes, sir.

Chairman ROTH. Now, Mr. Weller, didn't you in an effort to ease any concerns by the Navy about Penn Ship's financial condition offer to put all of the assets of Penn Ship in a trust indenture for the benefit of the Navy in case of a determination of default?

Mr. WELLER. I believe I made that, yes, sir. As I recall, I made that, that offer to the Navy, to include the Penn Ship assets.

Chairman ROTH. Mr. Weller, isn't it true that Penn Ship's attorneys drafted the trust indenture and the related mortgages and security agreements?

Mr. WELLER. Yes, sir, that is correct, to the best of my knowledge, and they were also negotiated and fully reviewed by the Navy.

Chairman ROTH. Now, it is my understanding that the trustee was responsible for protecting the Navy's fiduciary interest under the agreement. Is that your understanding?

Mr. WELLER. Yes, sir. As I recall, that would be my understanding.

Chairman ROTH. Who was the trustee, and who chose them?

Mr. WELLER. It is my recollection that we recommended that Fidelity Bank be the trustee.

Chairman ROTH. Penn Ship, in other words, selected the trustee?

Mr. WELLER. Yes, sir. We recommended the trustee.

Chairman ROTH. Now, wasn't Fidelity Bank also Penn Ship's bank?

Mr. WELLER. Yes, sir. As I recall, we had a relationship with them.

Chairman ROTH. Did Fidelity Bank ever make loans to Penn Ship at the same time they were acting as a trustee for the Navy?

Mr. WELLER. Yes, sir, they did.

Chairman ROTH. Now, doesn't it appear that Fidelity Bank was in a conflict-of-interest position being your bank as well as a trustee charged with protecting the interest of the Navy?

Mr. WELLER. Mr. Chairman, at the time, this was looked at by Fidelity, by the Navy, and by our attorneys, and no one ever raised the issue of any potential conflict.

Chairman ROTH. That doesn't answer my question, Mr. Weller. My question is wasn't there a conflict of interest.

Mr. WELLER. I am not a lawyer, sir. I can't tell you. All I know is that since this issue was raised, we have looked into it, and there is a Trust Indenture Act of 1939 that says these relationships can exist, and I will be happy to furnish you a copy of that Act.

Mr. DYER. If I might clarify——

Chairman ROTH. I am sorry. The only persons permitted to answer questions are the witnesses.

Mr. Bennett. Mr. Chairman, may I ask——

Chairman ROTH. No.

Mr. BENNETT [continuing]. The Chairman a question in fairness to our clients? We would respectfully request, just out of fundamental fairness, if we are going to be asked questions that raise legal

issues, neither Mr. Weller or Mr. Stevens can answer those, in fairness, Mr. Chairman.

Chairman ROTH. Mr. Bennett, Mr. Weller has shown that he is able to answer my questions. If he is not able to, he can so state, but counsel may not make statements here. Counsel may advise their clients of their legal rights.

Mr. BENNETT. We understand, Mr. Chairman, other counsel have given statements to the Subcommittee.

Chairman ROTH. There will be no statements by counsel.

Mr. BENNETT. Yes, Mr. Chairman.

Chairman ROTH. Mr. Stevens, isn't it true that on November 15, 1988, you sent a letter to Harold Hanson, the Navy contracting officer, threatening bankruptcy if demands were not met?

Mr. STEVENS. As I recall, Mr. Chairman, that letter indicated that if—I don't know that "demands" is the proper word. I think we were looking for payment on some invoices or some release of retentions—I am not clear—and that what we said was that in the event we didn't receive those payments promptly that we would probably have to close our doors, and that a copy of the letter was being sent to our bankruptcy counsel.

Chairman ROTH. Well, Mr. Stevens, a copy of a letter has been handed to you, which is dated November 15, 1988,[1] and presumably signed by you. Is that correct?

Mr. STEVENS. Yes, sir, that is correct.

Chairman ROTH. Would you read the third paragraph?

Mr. STEVENS. "A copy of this letter, I am placing our workout and bankruptcy counsel on immediate alert to advise us of steps that we should take." That comment is in reference to the paragraphs above.

Chairman ROTH. Now, isn't it true that shortly after writing that letter, didn't Penn Ship, in fact, receive in January 1989 a $10 million advanced payment from the Navy?

Mr. STEVENS. Yes, sir.

Chairman ROTH. In your written statement, you stated that, "At the end of 1988, if the Navy had provided," and I quote, "a moderate amount of financial help, Penn Ship could have completed the vessels," end of quote.

You failed to mention that Penn Ship received a $10 million advanced payment from the Navy shortly thereafter. Wasn't this the kind of help you were looking for?

Mr. STEVENS. No, sir, not at all.

Chairman ROTH. Ten million dollars was not a "moderate amount of financial help?"

Mr. STEVENS. No, sir. My comment had to do with the fact that we knew that the cost of the program was going to exceed the available funds, and we were seeking help from the Navy in the form of financial assistance to change the contract price so that we could get enough contract funds in the program to complete the vessels.

The $10 million advance was an advance against existing contract funds to pay past-due vendors, and it was not a change in the contract price at all.

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[1] The document referred to was marked Exhibit No. 10, and appears on page 199.

Chairman ROTH. Isn't it true that at the time of this cash advance, Penn Ship's cash flow became so bad that the company did not pay to United Way the contributions Penn Ship had withheld from employees' paychecks? Isn't it also true that Penn Ship submitted a bill to the Navy for payment of this $25,000 debt to United Way which the Navy paid out of the $10 million advanced payment account?

Mr. STEVENS. Yes, sir, it did. That payment was made along with a lot of other payments for things like electricity and the other bills that were obligations of the company and part of our overhead that had to be paid.

Chairman ROTH. Let me ask you this. What did you do with the withheld contributions to United Way?

Mr. STEVENS. I can't answer that in any direct kind of way, Mr. Chairman. You know, we have an accounting department that collects funds from whatever source and pays those funds out to meet our obligations, and I would assume that they were late making the United Way payment, just as they were late in making payments to a lot of other creditors, and that is, in fact, the reason that the advanced payment was set up in the first place.

Chairman ROTH. Now, after the contract was terminated, the two ships remained at the Penn Ship facility until they were towed to Tampa Shipyards. Isn't it true that Penn Ship was paid $45,000 a day and $90,000 on holidays to protect, preserve, and maintain the termination inventory for a total of $4.6 million?

Mr. STEVENS. Well, as I stated earlier in my statement, we were paid $45,000 a day, but that needs some clarification, sir.

This shipyard was a very large facility. We have 800,000, I think, plus or minus square feet of buildings and facilities on 150 acres, with all the machinery and the cranes and the other facilities, the drydocks that are there. When the work stopped, these two ships that were under construction were spread throughout this shipyard, and particularly ship No. 2, with the incomplete structural units, enormous amounts of outfitting materials like piping details and pipe package units, machinery package units, and steel outfitting materials, and in fact, when this shipyard was operating, if memory serves me correctly, I think our manufacturing overhead and G&A cost was approximately $40 million a year, which is about $800,000 a week, and that doesn't include direct labor cost.

So, when work stopped on these ships, we were able to dramatically cut that cost by, I think, 60 percent, so that it was in the vicinity of about $320,000 a week, but the requirements to collect, inventory, package, manifest, and load all these materials of equipment and supplies for the two ships, plus to prepare them for tow, as well as protect them in the interim time, was a big job.

As I recall, there were ultimately 500 to 600 trailer loads of material, quite a few rail cars, two oceangoing barges that were loaded, and we also loaded and prepared the ships.

To accomplish this, all of the facilities, the cranes, the drydock, and a very large work force, not just hourly people, but program management people, QA people, computer people, engineers, accountants, the whole facility had to be maintained in an operable condition and available to perform the load-out work, but we

couldn't perform that work until a completion contractor was selected.

Chairman ROTH. Just let me point out that, as I understand it, the termination contract provisions specifically provided payment of $45,000 a day and $90,000 on holidays to "protect, preserve, and maintain the termination inventory."

Let me proceed. Weren't you paid another $5 million under a completely separate contract provision to rig the ships for towing and load the materials for transfer?

Mr. STEVENS. Yes, sir. This all tied together.

As I just said, we had an agreement with the Navy to do this transfer of materials, which was a $5 million fixed-price contract. The shipyard's estimate, as I recall, was that this work would take about 12 weeks to accomplish.

Chairman ROTH. Senator McCain.

Senator MCCAIN. Thank you, Mr. Chairman.

Mr. Stevens, what is the status of Penn Ship at this time, the corporation?

Mr. STEVENS. Penn Ship is no longer in existence, sir. It has been merged out of existence. The shipyard itself is closed.

Senator MCCAIN. The shipyard itself is closed.

Mr. STEVENS. Yes, sir.

Senator MCCAIN. Does that mean that the——

Mr. STEVENS. It was a direct result of the loss of the T–AO contract.

Senator MCCAIN. The company is in bankruptcy?

Mr. STEVENS. No, sir, it is not in bankruptcy.

Senator MCCAIN. The corporation has other interests?

Mr. STEVENS. Yes, sir.

Senator MCCAIN. Like what?

Mr. STEVENS. The Pennsylvania Shipbuilding Company doesn't have other interests, but our company has other interests. We own a marine container and breakbulk terminal and a ship repair company in Texas.

Senator MCCAIN. What is it that made you and Mr. Weller have some confidence that you would be able to perform this contract successfully?

Mr. STEVENS. Senator, when we purchased this company in 1984 from Mr. Paden, who had purchased this company in 1982 from Sun Oil Company, we looked at the management team that was there. We looked at the facilities that were there. There were a lot of very competent people in that company, and they had done a lot of work.

The company that Mr. Paden had owned, Levingston Shipbuilding Company, had built a number of very complex offshore drilling rigs, including semi-submersibles.

The Sunship Company had built a ship called the Glomar Explorer, which you may be familiar with, which was a very complex vessel that was commissioned by the CIA to lift a Russian nuclear missile sub off the ocean floor, and they had built many, many commercial tankers and other ships.

Senator MCCAIN. On Tuesday, May 2nd, Captain Schrodt, who was the SUPSHIP for the oiler contract that Penn Ship stated: "As early as October 14, 1987"—since 1987—he told his superiors, "My

evaluation was that Penn Ship could not build and deliver any T–AO's within the contract provision."

Did he share that view with you?

Mr. STEVENS. I can't recall, Senator. I do remember visiting Captain Schrodt in late 1987 and telling him that we thought that the contract value was going to be difficult to deal with, and subsequently, we visited the Navy to have those discussions.

In early 1988, based on some conversations that we had had with the Navy, they were questioning our ability to do that, we hired the Advanced Technology Team, which was a very respected team of retired Navy Admirals and other Navy personnel who the Government had hired to help solve some similar problems at Bath Shipyard.

Those gentlemen went through our facility and found that we had the management, the personnel, and the facilities to complete the ships if we could just get a little more cooperation and assistance from the Government.

Senator MCCAIN. But yet, at the same time, the Navy was saying you didn't have qualified management and that you didn't have especially the kind of skilled labor that would be necessary to perform this contract. How do you reconcile those two views? I guess along with that, did you pay those people to make that assessment?

Mr. STEVENS. Yes, sir, we did. In fact, it was those allegations that gave rise to us hiring those consultants in the first place.

We wanted to be confident that our senior managers understood what they were saying, and the Navy was making these allegations, and so we said, well, let's get some people in here who understand this business and are very skilled in this business and ask them to tell us what they think.

Senator MCCAIN. Well, in your view, were they correct?

Mr. STEVENS. Well, yes, sir, they were correct, and I think that should be obvious by the fact that we completed 91 percent of the T–AO 191. That is all but the last 9 percent of the ship. It made no sense to take that ship out of the shipyard.

Senator MCCAIN. Why do you think the Navy made the decision that they did?

Mr. STEVENS. I wish I knew the answer to that, Senator.

Senator MCCAIN. Wasn't it true that there were already significant cost overruns associated with the construction of the ship?

Mr. STEVENS. Yes, but the contract funds had not been exhausted.

Senator MCCAIN. Well, in all due respect, the Navy has a responsibility at some point to say, look, we have spent X amount of additional money over the additional contract, and to find someplace else to complete it. Now, that is a separate part of this hearing as to that decision, but there is very strong testimony on the part of those who were directly involved, i.e., Captain Schrodt, that they had spent enough.

Mr. STEVENS. Well, two things, Senator. Had the Navy put an additional amount of money into this contract, we would have been able, under the terms of the trust indenture, to provide the Navy with the funds that would have covered that and probably a smaller amount than they ultimately wound up paying, No. 1, and No. 2, we had a very difficult time with SUPSHIP's management, who

failed to recognize that this was supposed to be a commercial ship and not a Navy military spec ship, and it caused us great problems.

Senator MCCAIN. Well, let me say, Mr. Stevens, that those same kinds of specifications were being imposed on the shipyard in Avondale, and they were able to complete them on time and at cost.

Mr. STEVENS. Well, Senator, I do not know the Avondale SUPSHIPs nor the relationship they have there. I just know ours.

Senator MCCAIN. Well, let me assure you that the same standards are employed throughout.

Let me ask, and I will be asking this of the other witnesses, did you hire or retain lobbyists during the period that your shipyard was responsible for work on those ships?

Mr. STEVENS. I don't recall that we did. I don't know the answer to that.

Oh, we did? Excuse me. I am corrected, sir. We did, yes.

Senator MCCAIN. Do you remember who they were?

Mr. STEVENS. Steve Minikes with—I am not sure of the name of that firm at this point in time. I don't really remember. Reid and Priest.

Senator MCCAIN. What was the name again?

Mr. STEVENS. Steve Minikes.

Senator MCCAIN. Would you supply for the Subcommittee in writing regarding the amount of money spent for the service of these lobbyists?

Mr. STEVENS. We will try to do that for you, sir.

Senator MCCAIN. Thank you very much.

[The information follows:]

EXHIBIT B

2. Penn Ship lobbying expenses incurred during the 1984–85 timeframe.

Committee's question: Senator McCain: "Would you supply for the Committee, in writing, regarding the amount of money spent for the service of these lobbyists?"

Penn Ship response: During the period from 1984–1989, Penn Ship retained Stephan M. Minikes, Esq. for legal and lobbying serices. Mr. Minikes was a member of the Butler and Binion law firm until December 3, 1984, at which time he joined the law firm of Reid and Priest in Washington, D.C. An explanation of monies paid for these services is outlined on the enclosed corresponsdence provided to Penn Ship in response to Senator McCain's request at the May 4, 1995 Senate hearing. *See* enclosed correspondence from Reid and Priest.[1]

Were you aware that as far back in 1988 the Secretary of the Navy Ball said that he believed that Penn Ship and Tampa Shipyards could not remain viable? Were you aware of that at the time?

Mr. STEVENS. I don't know that I was aware of that at the time, sir. I have seen the letter that was written subsequently, and I would conclude that that is probably part of the reason the Navy wasn't interested in helping us survive this program.

Senator MCCAIN. Were you surprised at the decision to send the ships to Tampa?

Mr. STEVENS. Yes, sir, I was.

Senator MCCAIN. Why?

Mr. STEVENS. Well, basically for two reasons. It didn't seem to us that Tampa had the ability to complete the contract. These ships were engineered and designed to be built in a facility like

[1] The document referred to was marked Exhibit No. 33 and can be found on page 338.

Avondale or like Penn Ship, with enormous crane-lifting capacity and the kinds of facilities it takes to build one of these vessels.

In order to finish that job at Tampa, it would have taken a very large, in my opinion, reengineering effort that just wasn't called for, and in addition to that, we had asked the Navy if there was any industrial mobilization considerations that could be looked at from our perspective, and we were told that wasn't an option, but it turns out that it was an option, just not for us.

Senator MCCAIN. Would you agree now, at least in hindsight, that your original bid was drastically underbid for the cost of building these ships?

Mr. STEVENS. No, I wouldn't agree that it was drastically underbid. I will agree that it was an aggressive bid, and there were a number of assumptions in that bid that have proven, in hindsight, not to have been good assumptions because they didn't pan out, but had those assumptions panned out, I think this shipyard would have built the ships.

Senator MCCAIN. Mr. Stevens, in all due respect, if the assumptions were wrong, then the bid was wrong.

Mr. STEVENS. We didn't know that at the time, of course, Senator.

Senator MCCAIN. Well, I think that statement speaks for itself.

Mr. Chairman, I have no more questions.

Chairman ROTH. Senator Nunn.

Senator NUNN. Just a few questions, Mr. Chairman.

At the conclusion of your statement, Mr. Stevens, you say the General Accounting Office issued a number of reports on this problem. This is talking about cost overruns. Estimating cost overruns over a target cost in the billions and overruns over ceiling prices in the hundreds of millions.

The word "ceiling prices," what does that mean to you, a ceiling price?

Mr. STEVENS. That, in terms of our contract, is the maximum liability for the Government under the contract. In our case, because the contract is stated in a fixed-year dollars, that number in our case does not include things like escalation and change orders.

Senator NUNN. But there was a ceiling. There was a definite ceiling in your contract.

Mr. STEVENS. Yes.

Senator NUNN. You entered into that contract knowing there was a ceiling.

Mr. STEVENS. Yes.

Senator NUNN. But didn't you say throughout your whole statement, one direct or indirect statement after another, that the Government could have given you more money or eased up or been more flexible? Did the Government have an obligation to do any of that?

Mr. STEVENS. No.

Senator NUNN. Why do you think the Government should do that? What was the policy reason you believe the U.S. Government and the taxpayers should ignore the ceiling, ignore the contract, and keep giving you money?

Mr. STEVENS. Well, I don't know that they should ignore the ceiling and the contract and keep giving us money. We thought we had

some legitimate claims against the Government for a part of that money. We, unfortunately, were not in the position to go through the legal effort that it would take to file those claims and survive the time period between the time of the filing and when we might actually get them resolved, No. 1, and No. 2, we had the trust indenture in place where we were willing to provide some financial reimbursement, in a sense, if we could change the contract.

Senator NUNN. Did you want to borrow money from the Government, or did you just want the Government to give it to you?

Mr. STEVENS. We didn't want them to give it to us. We wanted them to increase the contract price on what we thought were valid reasons.

Senator NUNN. Well, what were the valid reasons?

Mr. STEVENS. Again, I don't know that I can get into all of the claims issues that we were trying——

Senator NUNN. I am not talking about claims. Let's set claims aside. I know that was important to you, but your statement is not talking about claims.

You keep talking about or insinuating the U.S. Government, the Navy, has an obligation to, in effect, the way I read your statement, give you money because you were running into trouble even though there was a ceiling price, and my question to you is why do you think the Government ought to give you money.

Mr. STEVENS. Well, I don't think they ought to give us money. I think it might have been in the Government's interest to have had the ships completed there, but I wouldn't view that as a gift. We were willing to reimburse the Government for it or do whatever it took to——

Senator NUNN. You mentioned the constant overruns over ceiling prices and GAO and so forth. You seem to be saying, the way I read your statement, that there were all sorts of overruns during this period of time and that you were kind of counting on those overruns and you were kind of counting on the Government giving you money.

Mr. STEVENS. No, sir, that is just not true. We were merely making the statement that the Government was handling other shipyards in a fashion that was a little different than this, and that maybe this program wasn't as important to them as those were.

Senator NUNN. Well, that may be true, but the Government didn't have the obligation to do that, right?

Mr. STEVENS. No, they did not, and we didn't expect it.

Senator NUNN. Isn't it true that during this period of time that that was sort of the contractor's assumption that if there were overruns that the Government somehow was going to come in and take care of those overruns, or if there were contract prices that the Government was going to ease up and be flexible?

Mr. STEVENS. It wasn't our assumption, and we had no reason to think that it was.

Senator NUNN. Well, your statement is just full of statements that indicate that, that you believe that that should have happened and that you feel that it is almost a sense of injustice that the Government didn't give you money.

Mr. STEVENS. No, sir. What we said was we thought that those ships could have been completed at Penn Ship for less money than

they could have been completed anywhere else, possibly excepting Avondale, and that we were willing to enter into an agreement, in fact, to transfer them to Avondale, and we would pay our excess reprocurement liability, therefore. The excess reprocurement liability, we felt, would be lower if it was done at Penn Ship than somewhere else.

Senator NUNN. But the Government had no obligation to do that, right?

Mr. STEVENS. No, sir.

Senator NUNN. And the Government had every right to take those ships at the time they took them and send them wherever they wanted to?

Mr. STEVENS. Yes, sir, that is exactly right.

Senator NUNN. So you weren't mistreated, then?

Mr. STEVENS. No, I wouldn't characterize it as mistreatment. No.

Senator NUNN. The Government didn't do anything unfair as far as you are concerned?

Mr. STEVENS. No, sir, not unfair, not in the procurement side of the contract. We had grievances against the contract management, but not that issue.

Senator NUNN. You mentioned several times that the Government's liability did not increase. You made a big thing of rebutting any presumption of previous indication that the Government liability had increased, correct? You are saying adamantly the Government liability did not increase on these contracts?

Mr. STEVENS. As reference to ceiling price, yes, sir, that is correct.

Senator NUNN. But isn't it a fact that that is exactly what you wanted to happen was the Government liability to increase? It just didn't happen because the Navy wouldn't agree to it. Is that right?

Mr. STEVENS. Well, based on the fact that we thought we had some legitimate claims to pursue on that basis, yes.

Senator NUNN. And based on the fact that you believe that if the Government had given you money, it would have been cheaper than going out and getting another contractor? If the Government had gone over its own ceiling and gone beyond its own obligation, you would have done better than subsequent events proved to have occurred in other shipyards?

Mr. STEVENS. I am sorry, Senator. Could you ask that again?

Senator NUNN. Yes, I will rephrase it. In other words, you believe if the Government had just given you more money over the ceiling price that you would have been able to complete those ships better than happened in the other shipyard.

Mr. STEVENS. Well, I think it would have been better than what happened in Tampa, and I think it would have been less expensive at the date that we are talking about to have done that as compared to shipping them to Avondale.

Senator NUNN. Do you accept any responsibility for the failure to deliver these vessels, Mr. Stevens?

Mr. STEVENS. Well, yes, sir. We obviously have responsibility because we didn't do it.

Senator NUNN. Well, where did you go wrong?

Mr. STEVENS. As I have said, I think that we had some assumptions in our bid that proved not to be accurate. We take respon-

sibility for some of those, and some of those, we think were a product of the way the contract was managed by the Government.

Senator NUNN. Did the Navy ever promise you future work? Did they ever tell you we promise you, you are going to get other ships?

Mr. STEVENS. No, sir, they didn't—they can't do that. They didn't promise it.

Senator NUNN. But that, in effect, you were counting on it. Is that right? You were counting on future contract awards.

Mr. STEVENS. Why, sure.

Senator NUNN. To spread your overhead.

Mr. STEVENS. Sure. I mean, that is part of the process. You have to keep winning work in order to keep a facility like that competitive.

Senator NUNN. So your original bid, then, was not appropriate for the work you were doing with those two ships. Is that right?

Mr. STEVENS. I am sorry?

Senator NUNN. Your original bid was not appropriate, then. It was too low for the work you were going to do on those two ships. Your bid, your original bid, depended on getting further work.

Mr. STEVENS. Well, we contemplated getting additional work, yes, some additional work. I don't remember the——

Senator NUNN. But that is another way of saying your original bid was lower than you could do the work for, correct?

Mr. STEVENS. Well, Senator, if you would try to look at that as a stand-alone project and assume that the only thing you were going to be doing in that shipyard was to build these four ships and nothing else, I think probably everybody's bid would be too low to look at it from that perspective.

Senator NUNN. Were you doing any work other than Government work?

Mr. STEVENS. Some amount of other work. I have no recollection at this point just how much that was.

At this point in time, there was very little commercial work available in the rest of the industry. The Navy was basically the only supplier of work to the shipbuilding industry at this point in time.

Senator NUNN. Thank you, Mr. Chairman.

Chairman ROTH. Thank you, Senator Nunn.

Gentlemen, those are all the questions we have at this time. We may submit further questions in writing, which we would appreciate your answering.

You are excused.

Mr. STEVENS. Thank you, Mr. Chairman.

Mr. WELLER. Thank you, Mr. Chairman.

Chairman ROTH. Our next witness is William R. Boyles, Jr., vice president of finance for Tampa Shipyards, Inc.

Mr. Boyles, if you would take the center chair. As you know, we swear in all witnesses. So would you please rise and raise your right hand.

[Witness sworn.]

Chairman ROTH. Please be seated.

Mr. Boyles, you are accompanied by counsel today. Would you please introduce them.

Mr. BOYLES. On my left is Bob Banker with the firm of Fowler, White, in Tampa, and on my right is Arnold Burns with the firm of Proskauer Rose.

Chairman ROTH. Mr. Boyles, your written statement will be included as part of the record. As we indicated earlier, we appreciate your summarizing that and keeping it within 10 minutes.

Mr. BOYLES. Thank you, Mr. Chairman.

Chairman ROTH. Please proceed.

TESTIMONY OF WILLIAM R. BOYLES, JR.,[1] VICE PRESIDENT, TAMPA SHIPYARDS, INC.; ACCOMPANIED BY ROBERT E. BANKER, ESQ., FOWLER, WHITE, GILLEN, BOGGS, VILLAREAL AND BANKER, P.A., AND ARNOLD L. BURNS, ESQ., PROSKAUER, ROSE, GOETZ AND MENDELSOHN

Mr. BOYLES. Mr. Chairman and Members of the Subcommittee, I am William Boyles, and I am currently vice president of finance, Tampa Shipyards, Inc.

Chairman ROTH. Would you pull the microphone closer to you? It is hard to hear you.

Mr. BOYLES. OK. Sorry.

I particularly want to address several misconceptions which may have come about as a result of Tuesday's testimony and some of which occurred a little earlier today.

First, contrary to some of the testimony you have heard, Tampa was a very good shipbuilding company. In the mid 1980's, Tampa successfully built five T–5 tankers for charter to the Military Sealift Command. The ships were completed early and within the contract price, with no cost overruns.

In the late 1980's, Tampa completed the conversion of two crane ships for MARAD. Although Tampa experienced cost overruns in excess of $13 million, the workmanship was considered to be excellent.

In the early 1990's, Tampa began the design and construction of the TAGOS surveillance ship. During the course of that work, Tampa earned every performance bonus available under the contract. In fact, the NAVSEA program manager described Tampa's performance on the TAGOS ship as "a model to be followed by other shipbuilders."

To even suggest that Tampa was not a good shipbuilder is totally false and a disservice to the thousands of hard-working men and women employed by Tampa.

Second, I understand that the Subcommittee questioned why the Navy determined that Tampa was essential to the industrial mobilization base in 1989 when it had previously determined that Tampa was not essential in 1988. Apparently, neither the Inspector General nor the Subcommittee had the justification and approval, which was executed by the Secretary of the Navy in 1989.

Our attorneys secured a copy of that document in a lawsuit against the Navy. At this time, I would like to offer that document into evidence and have it made a part of the record.[2]

Chairman ROTH. Without objection.

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[1] The prepared statement of Mr. Boyles appears in the appendix on page 168.

[2] The document referred to was marked Exhibit No. 13, and can be found on page 210.

Mr. BOYLES. Thank you, Mr. Chairman.

Mr. Chairman and Members of the Subcommittee, when you review that document, you will note that it specifically addresses the 1988 determination that Tampa was not essential and concludes that the further deterioration of shipyards during the previous year caused Tampa to become essential to the industrial mobilization base. This document fully explains the Navy's reasoning and analysis.

Mr. Chairman, I would also like to offer into evidence two letters from the Department of the Navy dated December 29, 1989, and February 14, 1990. These letters were previously marked as Tampa Exhibits 2 and 3 in a lawsuit against the Navy. They are not complete letters, but they are what was produced by the Navy.

Mr. Chairman, may I have them delivered to you? [1]

Chairman ROTH. Without objection.

Mr. BOYLES. Mr. Chairman and Members of the Subcommittee, when you review those letters, you will note the Navy concluded that Avondale's protest of the award of T–AO to Tampa was entirely without merit and should be denied.

In addition, I would like to quote from one of the Navy's findings in which they stated, "The Navy's decision was not improperly influenced by congressional pressure."

With reference to Avondale, I would like to point out to the Subcommittee that Avondale's financial statements and reports in 1991 and 1992 indicated that they, like most of their competitors, including Tampa, were on the verge of bankruptcy.

With regard to the phrase "bailout," this Subcommittee should be aware of the fact that in 1992, Avondale was claiming cost overruns in excess of $300 million, and that they were granted $25 million in Public Law 85–804 relief, or bailout, if that is the proper phrase.

Further, Avondale was paid $143 million in settlement of their cost overrun claims during 1993.

Last, but not least, I do want the Subcommittee to be aware of the fact that Tampa's T–AO ships, which were 95 percent and 85 percent complete, were not fully completed because the Navy decided there was no longer any need for T–AO 191 and 192. Subsequent to the issuance of the default, Tampa filed a petition to reinstate the T–AO contract. That petition included the following unrestricted and unequivocal offer or guarantee of George Steinbrenner:

One, an immediate infusion of cash or credit from George Steinbrenner in the amount of $11 million for the unrestricted use of Tampa. The Navy had previously projected that $6 to $10 million would be necessary to complete the job.

Two, a personal guarantee from Mr. Steinbrenner that T–AO 191 and 192 would be completed for the price provided by the contract. In the event that the cost of completion exceeded the contract price, Mr. Steinbrenner would have been personally responsible for any excess costs. Mr. Steinbrenner and Tampa waived any claim for cost overruns and guaranteed to deliver the ships to the Navy for the Navy's price.

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[1] The documents referred to was marked Exhibit No. 14 and 15, and can be found in the files of the Subcommittee.

Three, Mr. Steinbrenner guaranteed to maintain a minimum $1 million cash balance in the Tampa bank account until the ships were completed.

The Navy rejected this offer.

I want to thank the Subcommittee for allowing me to make these few comments. I will attempt to answer any questions you may have.

Unfortunately, you might call me the last of the Mohicans in that I am the only salaried employee who has remained with the company after bankruptcy. I may not be able to answer all your questions, but I will try.

Chairman ROTH. Mr. Boyles, in 1989, Tampa Shipyards bid on the two oilers left unfinished by the termination for default of Penn Ship.

Tampa was not the low bidder for this contract. What explanation was given for awarding the contract to Tampa Shipyards?

Mr. BOYLES. In the justification and approval that was made part of the record, the Secretary of the Navy determined that Tampa was, in fact, essential to the industrial mobilization base. It is my understanding the award to Tampa was made on that basis.

Chairman ROTH. Now, at the time Tampa Shipyards was awarded the Navy oiler contract, what was Mr. Steinbrenner's position with the company?

Mr. BOYLES. Mr. Steinbrenner was chairman of the board and acting president of the American Shipbuilding Company. He had no involvement in the operations of Tampa Shipyards.

Chairman ROTH. Is American Ship the parent?

Mr. BOYLES. Yes, sir.

Chairman ROTH. What interest did Mr. Steinbrenner have in American Ship?

Mr. BOYLES. Mr. Steinbrenner—first off, American Shipbuilding is a publicly owner company and formerly traded on the New York Stock Exchange. Mr. Steinbrenner owned approximately 10 percent of the outstanding shares at the time of the award.

Chairman ROTH. Is he the largest stockholder in the parent company?

Mr. BOYLES. Yes, sir.

Chairman ROTH. Now, did Mr. Steinbrenner use the political process in any way to get Tampa Shipyards classified as a necessary part of our industrial base?

Mr. BOYLES. No, sir, not to my knowledge.

Chairman ROTH. Did he have any lobbyists?

Mr. BOYLES. No, sir, we did not employ any lobbyists during the period that we are discussing.

Chairman ROTH. Did Tampa Shipyards representatives go to Penn Ship and inspect the two ships before submitting their bid?

Mr. BOYLES. Yes, sir. It is my understanding that in the short window that Tampa had available to submit a bid on the T–AO 191 and 192, we did send a team of our most senior production people up to Pennsylvania. They surveyed the ships as best they could in a period of less than a week and made the bid on the basis of their understanding based on what they saw.

Chairman ROTH. Didn't your contract with the Navy contain what is called an "as-is, where-is" clause, and what did that mean?

Mr. BOYLES. Mr. Chairman, I am also not an attorney, and I would have my own interpretation of what that may mean.

Chairman ROTH. What is your interpretation?

Mr. BOYLES. My interpretation would be the pig in a poke, so to speak. You don't know what you are getting other than what you can see, and I might add that one of the problems that we had a lot of difficulty with after we began work on T–AO 191 and 192 were the things that we couldn't see through observation of the ships up in Pennsylvania.

There were numerous defects, latent defects, equipment failures on installed equipment, very difficult, in fact, impossible to determine the extent of that type of problem with their ships.

Chairman ROTH. You are the financial vice president?

Mr. BOYLES. Yes, sir.

Chairman ROTH. Under this agreement which contained an "as-is, where-is" clause, that meant your company assumed certain responsibilities. You had the opportunity of inspecting the ship. Isn't that correct?

Mr. BOYLES. Yes, we did have the opportunity to inspect the ship.

Chairman ROTH. And your company entered the contract to complete the ships, did they not?

Mr. BOYLES. Yes, sir, no doubt about that.

Chairman ROTH. And the company had legal advisers?

Mr. BOYLES. Yes, we did. We had legal advisers available to us.

Chairman ROTH. So the company, as you say, was an experienced contractor, Naval contractor.

Mr. BOYLES. No, sir.

Chairman ROTH. It was not?

Mr. BOYLES. Not direct DoD contractor, no, sir.

Chairman ROTH. How about Government contracts?

Mr. BOYLES. The only direct Government contract that we had had prior to T–AO, in my experience with the company which is about 15 years——

Chairman ROTH. But as you said, you did have legal advice in entering the contract?

Mr. BOYLES. Yes.

Chairman ROTH. The original contract price to complete the two oilers was $49 million. How much did Tampa Shipyards receive from the Navy by the time the contract was ultimately terminated for default?

Mr. BOYLES. The $49 million number relates to the labor and overhead effort on the completion itself, and on the same basis, Tampa had been paid some $66 million at the time the contract was terminated.

Chairman ROTH. It did not receive $102 million?

Mr. BOYLES. Well, in total for all the aspects of the job, but the point I am trying to make is the $49 million number did not relate to, for example, material cost reimbursed basis.

Chairman ROTH. You were paid $102 million?

Mr. BOYLES. Roughly, yes, sir.

Chairman ROTH. And that didn't include the $18 million settlement figure?

Mr. BOYLES. Correct.

Chairman ROTH. The original obligation was to complete the two oilers for $49 million.

Mr. BOYLES. Again, those numbers are not directly comparable because the $49 million does not cover the full range of the work that ultimately was contracted for.

Chairman ROTH. And the ships, of course, were not completed.

Now, on May 26, 1992, Tampa Shipyards took the extraordinary step of submitting a request to the Navy for approximately $25 million under Public Law 85–804, which is commonly referred to as the bailout law. Why was the request denied?

Mr. BOYLES. I am not certain why the request was denied. We, in my mind, made not a case, but we identified those factors that we believed merited an increase in the contract price.

One could suggest that maybe the Navy turned that down because they didn't want to acknowledge that a contract initially let for $49 million was well in excess of twice that.

Chairman ROTH. How do you explain the award of the contract to Tampa Shipyards under the industrial-base justification and it not being deemed essential for national defense when requesting a bailout?

Mr. BOYLES. I think those determinations were made by different elements of the Navy.

Chairman ROTH. What action did Tampa Shipyards and George Steinbrenner take which prompted the congressional appropriation that increased the ceiling price on the contract by $45 million?

Mr. BOYLES. It is my understanding that Mr. Steinbrenner, as any citizen might, did speak with members of the Florida delegation in regard to his desire that we be treated fairly. We were a major employer in central Florida, and it is my understanding Mr. Steinbrenner did request that all representatives in the State see that we got fair treatment.

Chairman ROTH. Did you have any lobbyists——

Mr. BOYLES. No, sir.

Chairman ROTH [continuing]. To assist in securing the bailout?

Mr. BOYLES. No, sir.

Chairman ROTH. Or the appropriation matter?

Mr. BOYLES. No, sir.

Chairman ROTH. You had no lobbyists whatsoever?

Mr. BOYLES. No, sir.

Chairman ROTH. Are you aware of any visits by Congressmen or Senators to Tampa Shipyards prior to this congressional appropriation?

Mr. BOYLES. I am aware that several Congressmen and some senior representatives from the Department of the Navy visited our shipyard in the late summer of 1992, walked the ships, looked at the ships, and spent about, I guess, a half a day in our facility. I was not part of that visit. So I don't know exactly the full extent of the visit.

Chairman ROTH. Do you know who they were?

Mr. BOYLES. I found out since that Congressman Young and, I believe, Congressman Murtha.

Chairman ROTH. Now, as a result of this $45 million appropriation, didn't Tampa receive an immediate cash infusion of more than $12 million?

Mr. BOYLES. Yes, sir.

Chairman ROTH. Wasn't $2.2 million of the appropriation immediately used to pay back some of Mr. Steinbrenner's loans to the company and an additional $8 million used to secure two letters of credit that had been guaranteed by Mr. Steinbrenner personally?

Mr. BOYLES. No, Mr. Chairman.

Chairman ROTH. What was the situation?

Mr. BOYLES. The Appropriations Act did two things relative to Tampa. First, it increased the ceiling price for T–AO, as you indicated, by $45 million, which ultimately resulted in a payment on the T–AO contract of $12.1 million to Tampa. However, the——

Chairman ROTH. Would you say that again? I didn't hear you.

Mr. BOYLES. The $45 million increase in ceiling price equated to the $12.1 million payment on T–AO that you described. The other portion of the Appropriations Act that impacted Tampa was the settlement of the MARAD contract I made reference to earlier where the Act directed that Tampa be paid $13.3 million in settlement of that contract which was completed in 1989.

Now, it is our position that Mr. Steinbrenner, to the extent that he was paid out of those funds that were received from the Appropriations Act, he was paid from the proceeds related to the crane ship contract, and if I might tie that in, when Tampa completed the crane ship conversion in 1989, as I mentioned in my opening statement, we incurred a loss in excess of $13 million.

In that contract performance, we consumed all the available credit for the company. We had no credit left after that contract. When the T–AO contract was later awarded to the company, the company found it necessary—we couldn't get financing from any traditional source. We went to Mr. Steinbrenner. Mr. Steinbrenner put up the cash and other credit the company needed to embark on the T–AO contract. So, when we got the settlement from the crane ship contract in 1992, we merely repaid the funds that he had put up a couple of years earlier because we had none at that time.

Chairman ROTH. The money that went to Steinbrenner, weren't those funds that were desperately needed by Tampa to continue to operate? Wasn't there a cash flow problem?

Mr. BOYLES. Yes, sir, there had been a cash flow problem, and let me say that in taking $13.3 million and the $12.1 million that the company received shortly after the Appropriations Act, a total of $22.2 million went to pay vendors, those accounts payable, and other operating costs of the company outside of any financing-related arrangements with Mr. Steinbrenner.

Chairman ROTH. The company continued to have financial problems, cash flow problems, didn't it?

Mr. BOYLES. Yes, sir, it did.

Chairman ROTH. So that by paying those funds to the chairman of the board, those funds weren't available to help process the contract obligation. Is that correct?

Mr. BOYLES. No, sir. I think that——

Chairman ROTH. Were they available? If the funds were used to pay off Mr. Steinbrenner, were they available for other purposes?

Mr. BOYLES. Well, he wasn't paid off, Mr. Chairman.

Chairman ROTH. How were the funds used, then?

Mr. BOYLES. We paid a $2.2 million loan to Mr. Steinbrenner in consideration of his agreement to create a non-interest-bearing note for other money that the company owed him, totalling about $2.7 million.

Chairman ROTH. That $2.2 million paid to Mr. Steinbrenner was then not available for the operation or performance of the Naval contract.

Mr. BOYLES. No, sir, but at the same time, while Mr. Steinbrenner was there when the company needed him, I don't think that he—in fact, the company should have expected him to be a guarantor or creditor of the company.

Chairman ROTH. Now, Tampa Shipyards was classified as a small business. As such, didn't this enable Tampa to receive expedited payments of vendor and subcontractor invoices from the Navy?

Mr. BOYLES. Yes, sir. There is an advantage to being a small business in that you are able to bill the Navy on a more frequent basis. There is some leeway when you can bill for incurred cost.

Chairman ROTH. How did you obtain that classification?

Mr. BOYLES. By the definition of the Small Business Administration for shipbuilding.

Chairman ROTH. Did you use any lobbyists to help?

Mr. BOYLES. No, sir.

Chairman ROTH. None at all?

Mr. BOYLES. No, sir.

Chairman ROTH. Did Tampa Shipyards use these expedited payments to promptly pay its vendors and subcontractors?

Mr. BOYLES. Yes, sir, we did.

Chairman ROTH. At one point, didn't Tampa owe its vendors and subcontractors more than $10 million in overdue payments?

Mr. BOYLES. That is a possibility. I don't recall.

Chairman ROTH. How did you get into that position if you were receiving expedited payments?

Mr. BOYLES. Well, even though the designation as a small business does allow for expedited payments, one thing we did encounter was certain delays from time to time in the processing of our invoices on a timely basis.

Chairman ROTH. According to an August 1993 Defense Week article, Tampa Shipyards in this time of great financial distress bought two Cadillacs for their officers. Is this true?

Mr. BOYLES. No, sir. Let me clarify that. The officers in question bought the vehicles themselves. They were company cars, admittedly, and as soon as that information came to the attention of the board, the board demanded and directed they immediately dispose of those vehicles. That was not authorized by the board of directors.

Chairman ROTH. But initially, they were bought by the company?

Mr. BOYLES. Yes, sir.

Chairman ROTH. After termination for default, Tampa Shipyards sued the Navy. That suit has recently been settled for $18 million. How much of this $18 million will go directly to Mr. Steinbrenner,

and how much has been allocated for the creditors of Tampa Shipyards?

Mr. BOYLES. The distribution of the $18 million is dictated by the bankruptcy court order that was part of our plan of reorganization.

It is my understanding the creditors pool will receive something on the order of $5 million.

Chairman ROTH. How many cents on the dollar? Do you know?

Mr. BOYLES. I think it would depend on where the total allowed claims come out, but it is going to be, I think, somewhere between 15 and 20 cents.

Chairman ROTH. What will Mr. Steinbrenner receive?

Mr. BOYLES. Well, Mr. Steinbrenner, per se, doesn't receive funds directly from any settlement. The funds go to the company, and the company has to pay its obligations related to the bankruptcy for administrative and professional fees. The short answer is I don't know the answer to that question at this time.

The company does receive about $8.7 million out of the $18 million.

Chairman ROTH. Will that go to Mr. Steinbrenner?

Mr. BOYLES. Well, certainly the company owes Mr. Steinbrenner well in excess of $8.7 million of priority post-bankruptcy loans. So, even if it all went to Mr. Steinbrenner, he would still incur a substantial cash loss as a result of his involvement, but of course, all that money will not go because the attorneys come first and then other professionals and so forth.

Chairman ROTH. You are treading on dangerous grounds.

Mr. BOYLES. I apologize to any attorney.

Chairman ROTH. Senator McCain.

Senator MCCAIN. Thank you, Mr. Chairman.

How long have you been with the company, Mr. Boyles?

Mr. BOYLES. Sir, I began with the company in 1980.

Senator MCCAIN. 1980.

Mr. BOYLES. Yes, sir.

Senator MCCAIN. Wasn't it true that there were at least three changes in management during the time that the construction of these ships was brought on?

Mr. BOYLES. Yes, sir.

Senator MCCAIN. But you survived all of those changes?

Mr. BOYLES. Well, yes, sir. I was in the financial area throughout.

The changes you are referring to were operational-type changes.

Senator MCCAIN. So you really had very little to do with the operational side of the house?

Mr. BOYLES. Certainly not in directing that, but at the same time, I was well aware of the impact of the operations because of the financial aspect.

Senator MCCAIN. But you weren't a decision-maker?

Mr. BOYLES. No, sir, I was not.

Senator MCCAIN. In regards to the settlement here on the crane ship side, because it was brought up—I know it is not the subject of this hearing—is it true that, first, the Navy offered $1.2 million? That was the Navy's initial offer for a settlement on the crane ship issue?

Mr. BOYLES. I believe the Inspector General reported that.

Senator McCain. Is it true that the company then offered in response $3 to $4 million as their request, somewhere between $3 and $4 million to settle the crane ship side of the issue?

Mr. Boyles. I don't recall that sort of offer. We felt that we were entitled to the $13.3 million throughout is my understanding.

Senator McCain. There is no record of an offer of settlement between $3 and $4 million?

Mr. Boyles. I can't. There may well have been. I am not aware of it.

Senator McCain. That is the information that we have, and I would like you to provide that for the record because it is rather important.

The Department of Justice tells us that the company offered the Navy a $3 to $4 million settlement in response to the Navy's offer of $1.2 million. So would you provide that for the record as to whether that is the case?

Mr. Boyles. Yes, sir, I will look into that.

Senator McCain. The Department of Justice then goes on to say that they rejected that as being too high. You have no recollection of that process taking place?

Mr. Boyles. No, sir. I was not a party to that.

Senator McCain. Well, it is important because we ended up then with a congressional appropriation of $13 million, and obviously, that has some bearing on the issue. If the Navy was offering $1.2 million, the company in return was asking for $3.4 million, the Department of Justice said that was too high, and then while this process is going on, $13 million of a $58 million appropriation is given to your company.

There was an $18 million settlement that the Chairman just discussed with you, and you said the creditors get $5 million.

Mr. Boyles. Approximately, I believe that is——

Senator McCain. Approximately $5 million.

The "company" gets $8.7 million. I figure that to be about $13.7 million. Is the rest attorneys' fees?

Mr. Boyles. No, sir. The secured creditors get a portion. In fact, I think that is where all the rest of it goes is to secured creditors, pre-petition.

Senator McCain. The $8.7 million to the company——

Mr. Boyles. Excuse me, Senator.

Senator McCain. Yes.

Mr. Boyles. I have just been corrected. The amount going to the unsecured creditors would be about $6 million.

Senator McCain. $6 million.

Mr. Boyles. Yes, sir.

Senator McCain. And $8.7 million to the company.

Now, is the company's first obligation to pay Mr. Steinbrenner?

Mr. Boyles. I think in a legal sense, it would be.

Senator McCain. Do you contemplate that you would not pay Mr. Steinbrenner first?

Mr. Boyles. No, sir. That hasn't been determined.

Senator McCain. Do you have any reason to believe that he would not be paid first?

Mr. BOYLES. Well, in my opinion, if we paid—the company is obligated to pay the entire amount to him because that amount is less than what he has lent subsequent to the bankruptcy.

Senator MCCAIN. I understand, Mr. Boyles, but the fact is money that goes "to the company" really goes to Mr. Steinbrenner.

Mr. BOYLES. Yes, sir.

Senator MCCAIN. OK. That is what I was trying to establish.

Explain to me, Mr. Boyles, how this company was designated as a small business.

Mr. BOYLES. The criteria for small business in shipbuilding is an average 52-week employment level of less than 1,000, and I think a 3-year average revenues of less than $100 million. We met that criteria.

Senator MCCAIN. Now, this company itself, though, is part of a larger conglomerate corporation?

Mr. BOYLES. No, sir. Well, Tampa Ship was wholly owned by the American Shipbuilding Company.

Senator MCCAIN. Which——

Mr. BOYLES. Which also owned another operation called Nashville Bridge Company, and that is the extent of the operating entities of the American Shipbuilding Company at the time of the contract award.

Senator MCCAIN. I am sure there is something which is not unusual that I don't get here, but it seems to me that it is not exactly what Congress had in mind when they designated companies as small businesses, but that is not your problem, obviously.

Mr. Boyles, on Tuesday, May 2, Captain Klein, who testified yesterday, noted that in his first report Tampa Shipyards would not meet the contract delivery dates, the company did not have the management capability in place to comply with the contract, that Tampa Shipyards was unwilling or unable to devote the necessary resources to the project, and that by every indicator available, Tampa Shipyards was in serious financial trouble and lacked the cash and credit resources to adequately perform the requirements of the contract. Did he share that information with you?

You state you are on the financial side. So you may be the wrong person to answer this question, but was that shared with the management of the company?

Mr. BOYLES. Well, I did not know that that was the attitude that Captain Klein had.

Now, it was well known that the company was somewhat thinly financed throughout the period.

Senator MCCAIN. You state that the Navy caused the bankruptcy of Tampa Shipyards, but isn't it also true that Tampa Shipyards had lost money every quarter prior to the awarding of the oiler contract?

Mr. BOYLES. The last profitable year for the American Shipbuilding Company before the award of T–AO was in 1986.

Senator MCCAIN. 1986.

Mr. BOYLES. Yes, sir.

Senator MCCAIN. The award was made——

Mr. BOYLES. In 1989.

Senator MCCAIN. So, for three previous years, the company had lost money every quarter?

Mr. BOYLES. Yes, sir.

Senator MCCAIN. In answers to the Chairman's questions, you said there were no lobbyists who were hired in order to represent—which by the way is a legitimate enterprise. I am not criticizing that practice. People hire consultants all the time, and I am not criticizing that practice. You stated to Chairman Roth that the company did not hire any lobbyists or anyone to represent them here in Congress. Is that an accurate response to Chairman Roth?

Mr. BOYLES. Yes, sir.

Senator MCCAIN. How do you explain the New York Times article and Legal Times article which said: "Last month, Steinbrenner and his top D.C. lobbyist, William Ragan, pulled off a lobbying ploy as rare as an inside-the-park home run." Do you know anything about employment by Mr. Steinbrenner of Mr. Ragan?

Mr. BOYLES. We at one time did employ Mr. Ragan's firm. I was not aware that Mr. Ragan was considered to be a lobbyist, per se. We sought his legal advice.

Senator MCCAIN. Do you think that Mr. Ragan is listed as a lobbyist, as lobbyists are required to do with the Congress?

Mr. BOYLES. I am not certain of that, sir.

Senator MCCAIN. How about Mr. Magliochetti? Do you know anything about his work for——

Mr. BOYLES. Could you repeat that, sir?

Senator MCCAIN. Mr. Paul Magliochetti. Do you know anything about his employment?

Mr. BOYLES. Mr. Magliochetti. The company engaged Mr. Magliochetti's firm in early 1992 to perform an analysis of the management and operations of the company.

Senator MCCAIN. Is Mr. Magliochetti's firm located here in Washington?

Mr. BOYLES. Yes, sir.

Senator MCCAIN. According to a Washington Post article—and I will be glad to give you a copy of this—it says, "Last spring, Steinbrenner dispatched two lobbyists to Capitol Hill, Paul Magliochetti, an aide in the House Subcommittee from 1981 to 1987, and William F. Ragan. Both lobbyists had made contributions. . . ." Do you know anything about the employment of those two individuals, or is this Washington Post report wrong?

Mr. BOYLES. Well, I can't speak to the characterization of those individuals as lobbyists. Mr. Ragan, from my understanding, was an attorney, and we used him for legal work relative to——

Senator MCCAIN. Well, do you dispute that The Washington Post article says they dispatched them to Capitol Hill?

Mr. BOYLES. I don't have any knowledge of that. I can't dispute it.

Senator MCCAIN. Well, I guess I will have to ask, Mr. Boyles, if you will provide for the record—and I think Mr. Steinbrenner's legal counsel is here. Maybe Mr. Steinbrenner employed them himself rather than the company, but there are allegations that these two individuals lobbied Capitol Hill which, by the way, may be perfectly legitimate. I am not saying that there is anything improper or illegal about that. For the record, perhaps you could provide

what they did, and under what terms, for the benefit of the Subcommittee.[1]

Mr. BANKER. If I may, Senator, I think Bill just simply doesn't know other than one was a lawyer and the other one did the consulting, and I think that is what his response was.

Mr. BOYLES. Right.

Chairman ROTH. We will limit all answers to the witness.

Mr. BANKER. I am sorry. Yes, sir.

Senator MCCAIN. Well, I just don't think it is candid, Mr. Boyles, for you to say no to Chairman Roth when clearly there was some involvement, several media sources, including the New York Times, including The Washington Post, including Legal Times, who have been very badly misinformed, and I think this needs to be clarified.

Mr. BURNS. With due respect, Senator——

Chairman ROTH. The witness will answer.

Mr. BURNS. I know. I just want to make this comment.

Chairman ROTH. No. There will be no comment by the counsel.

Mr. BURNS. Well, then I am going to have to consult with the witness.

[Mr. Boyles and Mr. Burns conferred.]

Mr. BOYLES. I didn't intend to mislead the Chairman.

Senator MCCAIN. Oh, I am sure you didn't.

Mr. BOYLES. I was basing my answer to him on my understanding of what these individuals, who I know were employed by the company, what their role was.

It is my understanding Mr. Ragan is an attorney. Mr. Magliochetti did consulting work for us, and that was the basis for my answer.

Senator MCCAIN. I will bet half the lobbyists in this town are attorneys, Mr. Boyles. They are registered as lobbyists, and they work on Capitol Hill, and I would suggest that——

Mr. BOYLES. I am not familiar with that industry.

Senator MCCAIN. I think you know my request to provide that information for the record.

Mr. BOYLES. Yes, sir.

Senator MCCAIN. Could I ask another area, very briefly?

The Navy denied Tampa Shipyards' request for more money in August 1992. Do you agree with that?

Mr. BOYLES. Yes, sir.

Senator MCCAIN. Rear Admiral Eugene Harshberger, Deputy Commander for Contracts, turned down Tampa Shipyards' request in a sharply worded memo declaring that even if it got the money, the company still might not be able to finish the two Navy oilers. Tampa Shipyards' own study showed—this is according to his letter—has a properly managed staff to organize to complete the contract, Harshberger wrote. Also, he said Tampa Shipyards needed significantly more than the $24.5 million it had requested to finish the job, but when Harshberger sent Tampa Shipyards a copy of the memo on August 7, things happened, and of course, in October—this is a little over 2 months after Mr. Harshberger said that Tampa should not have any additional money—Congress passed a defense bill that included $45 million in appropriations for Tampa

[1] The document referred to was marked Exhibit No. 12, and appears on page 202.

Shipyards to complete the two oilers, far more than the company originally requested from the Navy. Do you dispute that news account?

Mr. BOYLES. No, sir, I don't.

Senator MCCAIN. Thank you very much.

Thank you, Mr. Chairman.

Chairman ROTH. That completes the questioning at this stage.

Mr. Boyles, you are excused. Thank you for being here.

Mr. BOYLES. Thank you.

Chairman ROTH. We will now proceed to our next witnesses who will be Steven S. Honigman, who is General Counsel of the Navy; Ronald Kiss, Deputy Assistant Secretary of the Navy; and Harold V. Hanson, Contracting Officer with the Naval Sea Systems Command.

Gentlemen, as you all know, we swear all witnesses. So if the three of you would please rise and raise your right hand.

[Witnesses sworn.]

Chairman ROTH. Gentlemen, please be seated.

Mr. Honigman, if you would proceed. As I stated to the other witnesses, your full statement will be included in the record as if read. We ask that you summarize your statement.

TESTIMONY OF STEVEN S. HONIGMAN,[1] GENERAL COUNSEL OF THE NAVY; ACCOMPANIED BY RONALD KISS, DEPUTY ASSISTANT SECRETARY OF THE NAVY, AND HAROLD V. HANSON, CONTRACTING OFFICER, NAVAL SEA SYSTEMS COMMAND

Mr. HONIGMAN. Thank you, Mr. Chairman.

Mr. Chairman, distinguished Members of the Subcommittee, I am Steven S. Honigman, the General Counsel of the Department of the Navy. Thank you for this opportunity to appear before you today to discuss the Navy's T–AO 187 Class Fleet Oiler Program.

I am accompanied by Mr. Ron Kiss, the Deputy Assistant Secretary of the Navy for Ship Programs, and Mr. Harold Hanson, a Contracting Officer with the Naval Sea Systems Command.

I have prepared a written statement which details much of the history of this program. Thank you for entering that statement into the record. I would like to provide a brief opening statement.

At Tuesday's hearing, you emphasized your determination to ensure that the taxpayers get $1 worth of defense for every dollar they spend on defense. We share that determination, and we are working hard to achieve it. For that reason, the Navy is taking every action to make sure that we get full value for every taxpayers' dollar.

In all of our procurement, not just in shipbuilding, the Navy works to ensure that we obtain the greatest value for the taxpayer in terms of performance and other factors. We do not focus on procuring goods solely on the basis of price. Our analysis is now more sophisticated, and the tools at our command are better.

Let me tell you about a few of the things we are doing. We now use best-value procurements on a large scale. Best-value procurements enable the Navy to award to contractors who may not have

[1] The prepared statement of Mr. Honigman appears in the appendix on page 180.

the lowest price, but who offer the greatest value to the Navy in terms of performance and other factors, such as management capability, personnel qualifications, prior experience, past performance, schedule compliance, and cost. Therefore, a best-value procurement can result in the Navy's awarding a contract to a company other than the low-cost, technically acceptable offeror.

The evaluation scheme usually entails a comparison of the projected costs of the low, technically acceptable offeror with the projected costs of the higher-scored, technically acceptable offerors. The Navy then determines the cost premium it is willing to pay for a proposal that has a higher technical score and, thus, promises better value to the taxpayers.

An example of our use of the best-value principle is the September 1993 procurement of strategic sealift ships, which are large, medium-speed, roll-on/roll-off ships, to support the Army's mobility requirements.

Another is a recent phased maintenance contract for amphibious ships.

The Navy is also taking significant steps within the competitive rules to avoid buy-ins to contracts that result in financial losses for industry. There is every reason for the Navy to want to pay less instead of more on a contract, but only up to a point. Contracts which lead to losses inevitably lead to delays, claims, litigation, and serious difficulties in contract administration. Therefore, the Navy carefully scrutinizes both the financial responsibility of proposed contractors and the likelihood of their being able to fully perform the contract for the price proposed.

For example, in the procurement of the strategic sealift ships, the solicitation specified that if the Navy determined that an offeror's proposed target price was unrealistically low, then the Navy would not use the proposed target price for purposes of arriving at a total evaluated price. Instead, the Navy would use its own estimate of the final price to the Government.

During the evaluation, the Navy projected losses for two offerors and performed the price realism analysis which I have just described. The process was protested to the General Accounting Office which sustained the Navy's procedure.

Another example which indicates the Navy's commitment to avoiding buy-ins and contracts which result in financial loss to industry is the DDG–51 1994–1995 contract award. During the course of this procurement, the Navy's evaluation determined that the low prices fostered by the competition would result in financial losses to the competitors. To preserve the industrial mobilization base, the Navy allocated an equal number of ships to both competitors. Reasonable prices were then negotiated that should result in profitable contracts and a business environment that will make the Navy's contract administration more effective. We expect that the result will be reliable delivery of quality vessels at a fair value to the taxpayers.

Mr. Chairman, we believe that by implementing these approaches and by being open to new ideas for reinventing Government, we will continue to improve the manner in which the Navy awards contracts. Thus, this administration is emphasizing coordination of the requirements and acquisition processes so that the ac-

quisition process more closely reflects the actual current needs of the war fighters.

It was this interaction that led to the decision not to finish T–AO 191 and 192. Simply stated, the reason these ships were never completed is the absence of an operational requirement.

While the procurement process the Subcommittee is addressing today was going on, the world changed for the better. With the end of the cold war threat and the emphasis on downsizing, the Navy determined that only 16 of the original 18 oilers in the program were needed. These two oilers are single-hulled, the ones we are discussing today, while the remaining oilers under construction are double-hulled vessels that are better for the environment.

Therefore—and let me emphasize this "therefore"—since the contract for their construction had already been terminated for default, they were clearly the two ships to leave unfinished.

When John Dalton became Secretary of the Navy, he found a shipyard that was making little or no progress on its contract to complete T–AO 191 and 192. At the time of award, it was expected that Tampa would complete the ships for a cost of about $88 million, with the T–AO 191 to be delivered in 25 months and the T–AO 192 in 32 months.

By August 1993, completion projections for the ships had lengthened to 56 and 68 months. Moreover, there was no credible estimate of the cost that would be required to complete the ships or of Tampa's financial ability to fulfill its contract. Consequently, to prevent further loss to the taxpayers, Tampa's contracts for the oilers were terminated for default.

Tampa then came and asked the Navy to reconsider. To ensure that the Navy was acting fairly to Tampa and protecting the taxpayers, the Secretary directed the Defense Logistics Agency to develop an independent estimate of the cost to complete the ships. Based on historical trends supported by data on over 400 Department of Defense contracts, DLA concluded that the total cost to complete would be significantly more than the current contract value.

In DLA's view, it would have required the investment of as much as another $140 million on top of all the money already sunk in the ships. As part of this review process, the Navy took another hard look at the requirement for which the ships had originally been ordered. We found that the Naval force level following the Bottom-Up Review required no more than 16 T–AO's. I should note that the Bottom-Up Review was issued after the contracts were terminated for default. For that reason, the Office of the Chief of Naval Operations stated that the ships should be placed in a mothball lay-up status with minimal maintenance costs.

In sum, the contractor was not performing. There was no reasonable or credible estimate of the cost to complete the ships, and there was no longer any requirement for the ships. Therefore, the only responsible action was to terminate the program at 16 ships.

In consequence, the two T–AO's were placed in a long-term lay-up with no immediate plans to pursue completion at any other shipyard. However, they have not been simply abandoned to gather rust. Instead, they have been treated so that work on them could

resume if a need for them develops in the future, and in addition, the Navy has offered them for sale, as is, to foreign governments.

Mr. Chairman, this concludes my summary. My colleagues and I would be happy to address any questions that you may have.

Senator MCCAIN. Mr. Chairman, may I ask your indulgence to make a brief comment as a former Navy person to the witness? I know we have to break, but I just have a brief comment.

Chairman ROTH. Yes.

Senator MCCAIN. Mr. Honigman, I am embarrassed. I am embarrassed to hear a statement along those lines that this was the result of the fact of the end of the cold war. It was the result of a flawed, terribly damaged process that cost the taxpayers $400 million with nothing to show for it, and for you to come here and say, as you did in summing up that it has nothing to do with the procurement process but rather with operational requirements, simply stated, the world changed, is the height of sophistry.

I have only been in the Congress for 12 years, but I have never heard such a statement in my time here. With a procurement process that was flawed from beginning to end, with all kinds of mistakes and errors, egregious errors made, that we end up with two ships costing $400 million, sitting there rusting, in my view, it embarrasses me and it makes me ashamed.

I appreciate the indulgence of the Chairman.

Mr. HONIGMAN. If I may respond, Senator.

Chairman ROTH. Go ahead.

Mr. HONIGMAN. As I understand, this Subcommittee is addressing two issues. One is the procurement process that led to the fact that the $450 million was spent on these two ships. The other is whether the ships should have been completed somewhere.

I understand that what you are referring to, sir, is the last paragraph of my written statement. My intention in that paragraph was to address why the Navy chose not to take these ships to yet another yard and to finish them, and the answer to that, sir, is the requirement no longer exists for these two oilers.

Chairman ROTH. It is my understanding that we are beginning a series of votes at 12:15. So the Subcommittee will be in recess for one hour or such longer period as is required until those votes conclude.

Senator NUNN. May I ask one question, Mr. Chairman?

Chairman ROTH. Yes, Senator Nunn.

Senator NUNN. Mr. Honigman, as I understand what you are saying, you are saying you didn't finish the oilers because you didn't need them.

Mr. HONIGMAN. Mr. Chairman, we terminated Tampa's contract because Tampa defaulted. We then took a look at the requirement and determined that we would not complete the ships somewhere else because, as a result of changes in the world situation, they were no longer needed.

Senator NUNN. But in your statement here, you said, "Let me reiterate why the Navy never finished these . . . As you can see, the reason had nothing to do with the procurement process . . .," but that is taking a certain period of time in saying that this period of time when we finally decided to cancel, it was not the procurement process, but it was the world situation, we didn't need them,

but the procurement process had everything to do with these not being completed because they were being completed before the cold war ended, basically——

Mr. HONIGMAN. Oh, that is entirely correct, sir.

Senator NUNN [continuing]. That the procurement process worked. So, when you make that kind of sweeping statement, it would be very easy to come to the conclusion that the Senator from Arizona, Senator McCain, did that you are basically trying to say that there was no problem with the procurement process. I don't think that is what you are trying to say, but that is the way it comes across in this statement.

Before we break, what are you trying to say about the procurement process? Forget the end of the cold war. What are you trying to say about the procurement process in this situation? Was it botched? Did the Navy botch it, and if so, do you have anyone who was accountable for it? That is what we are trying to determine.

Mr. HONIGMAN. Mr. Senator, the procurement process included a number of decisions made by senior members of the Navy's leadership. Among those decisions were mobilization-based decisions and other decisions.

Senator NUNN. But my question is was it botched by the Navy. We are not going to have time at this point in time to get into all of that. Was this a flawed procurement process by the U.S. Navy?

Mr. HONIGMAN. In some respects, clearly it could have been done better.

Senator NUNN. My reading of that is it was flawed, but you don't want to say so. Is that correct? [Laughter.]

Mr. HONIGMAN. Mr. Senator, there are things I would have done differently if I had been there.

Senator NUNN. Let's list the things you would have done differently, just in simple terms, so we can all understand it. What should have been done differently in your more diplomatic prose?

Mr. HONIGMAN. Mr. Senator, looking at it in hindsight, I do not believe that it was the best judgment to go to Tampa Shipyards on the mobilization-based decision.

Senator NUNN. Another way of saying that was it was a bad decision, right?

Mr. HONIGMAN. Yes, sir.

Senator NUNN. OK. No. 1. Now, what else?

Mr. HONIGMAN. Well, sir, the Navy did its best, ultimately, not to continue to provide funds to Tampa Shipyards. I think that was a correct decision.

Senator NUNN. I am just trying to get the incorrect ones. The correct ones are a pretty short list here in this procurement episode. Let's get the longer list, which are the ones that were wrong.

The first thing, you shouldn't have awarded to Tampa Shipyards, right?

Mr. HONIGMAN. That is correct.

Senator NUNN. All right. Now, what else was wrong with the procurement?

Mr. HONIGMAN. It may be that we should have cancelled Penn Ship sooner.

Senator NUNN. When you say it may be, the way I read that is you should have, right?

Mr. HONIGMAN. Yes, sir.

Senator NUNN. You should have cancelled Penn because they clearly couldn't do it, right?

Mr. HONIGMAN. Yes, sir.

Senator NUNN. Should the award have been made to Penn to begin with?

Mr. HONIGMAN. That, sir, I am really not competent to address.

Senator NUNN. All right. We have got two mistakes the Navy made. What were the other mistakes the Navy made?

Mr. HONIGMAN. Mr. Senator, I think that our settlement with Tampa was appropriate. I think that the settlement reflected the litigation risk arising from certain aspects of the contract's management.

Senator NUNN. I am trying to get at the list, here again, of what went wrong. What else went wrong from the Navy's perspective?

Mr. HONIGMAN. I believe those were the major problems, Mr. Senator.

Senator NUNN. All right. Let's see if you can summarize those, then. Tell us what the major problems were.

Mr. HONIGMAN. I cannot comment on the decision to go to Penn Ship, but I believe that we could have left Penn Ship sooner.

I believe that the decision to go to Tampa Shipyards on the mobilization-based principle was flawed.

Senator NUNN. Tell me why that decision was flawed.

Mr. HONIGMAN. Mr. Senator, at the time that we determined to go to Tampa Shipyards, the theory was that Tampa was responsible as the contractor because this was a relatively small contract that should have been performed in a relatively short period of time.

Again, this was long before my time with the Department, but in retrospect, that appears to have been mistaken.

Senator NUNN. Should the Navy have understood at that time it was a mistake?

Mr. HONIGMAN. I understand that the Navy did make efforts, including retaining an independent accounting firm, but of course, hindsight is better than foresight.

Senator NUNN. You have reviewed this record pretty carefully, right?

Mr. HONIGMAN. I have done my best, sir, yes.

Senator NUNN. That decision to go to Tampa after Penn ran into the trouble, was that a decision based on the merits of the case or was that a political decision?

Mr. HONIGMAN. Mr. Senator, the decision was reflected in documents in the record. The decision as reflected by the documents makes sense on its face.

At that time, it was felt there was a concern about making sure that we had necessary capacity to build larger auxiliary ships. There was a concern since the National Steel Shipbuilding Company had just been sold by its parent. There was some concern about whether it would continue to be sufficiently viable.

There was also an understanding that the Navy's fast sealift ship program was coming on the horizon, and therefore, it was felt there was a need to go to another competitor.

Senator NUNN. Are you saying that after reviewing the record, under oath here, you believe this was a decision made by the Navy based on the merits of the case to go to Tampa?

Mr. HONIGMAN. Mr. Senator, what I have done is to review the written record. What I can say under oath is that the reasons given appear to be sensible reasons, but I can't speak to the political context or any other reasons that there may have been.

Senator NUNN. Would it be fair to capsulate your testimony thus far as saying this was a flawed procurement process, the Navy made serious mistakes, but the oilers were cancelled because of the end of the cold war?

Mr. HONIGMAN. I think it would be fair to say that, looking in hindsight, there were mistakes made, but focussing only upon the question of whether the Navy should have taken the two ships from Tampa to someplace else and spend more taxpayers' money to complete them, my response is the changed conditions as a result of the end of the cold war, in my view, would have made that, yet, another mistake.

Senator NUNN. But the Navy did make serious mistakes in this procurement process?

Mr. HONIGMAN. In hindsight, Senator, yes, it appears things could have been done differently.

Chairman ROTH. Let me ask one further question. You didn't comment on the exercise of the two options with Penn Ship. Was that a mistake?

Mr. HONIGMAN. I really don't have a view on that, Senator, but I will be happy to respond after the break.

Chairman ROTH. I would like to have your comments on that.

Mr. HONIGMAN. Yes, sir.

Chairman ROTH. We will recess now until 1:15.

[Whereupon, at 12:20 p.m., the Subcommittee adjourned, to reconvene at 1:35 p.m., this same day.]

AFTERNOON SESSION [1:35 P.M.]

Chairman ROTH. The Subcommittee will please be in order.

We will continue with the questions. There is another vote, I understand, at 2 p.m., but we will play that by ear.

Thank you for your patience, Mr. Honigman.

You testified this morning that these ships had been treated to prevent rust deterioration. I direct your attention to those photographs of the ships taken within the last 2 weeks.

If they were treated, how do you explain the obvious rust and deterioration of the ships?

Mr. HONIGMAN. Mr. Chairman, if I may, I would like to ask Mr. Kiss to respond to that, but if I may make a brief comment first because I would like to correct one of my own mistakes, I read my written statement over during lunch, and I noticed an error in one portion.

In discussing the responsibility determination concerning Penn Ship, I made the comment that our pre-bid cost estimate was less than the contract ceiling price for which the Navy was contractually liable, and then I said, erroneously, and at the ceiling price, the contractor would make a small profit.

We should have said at the Government's estimate of cost, the contractor would make a small profit. Clearly, at the ceiling price, he would suffer a loss. I just didn't want that to go into the record without correction, sir.

Chairman ROTH. It will be duly noted.

Mr. KISS. Mr. Chairman, with respect to the rust, you are——

Chairman ROTH. Would you say again, Mr. Kiss, what your position is?

Mr. KISS. I am the Deputy Assistant Secretary for Ship Programs.

With respect to the rust, there is no way that a ship on the exterior part stowed in the weather could avoid rusting.

What the Navy did do in terms of putting these ships away to try to protect them to the maximum extent was the interior parts of the ship, where the machinery and the control systems are and vital control spaces, was under dehumidification, and there is virtually no humidity in those spaces, and that should prevent any rust or that kind of deterioration.

There is also protection for the underwater part of the hull to prevent corrosion, cathodic protection systems are available to try to prevent that.

The longer the ship sits in the weather, the more rust there will be top side, which is what you can see when you visit the ships.

There are normal maintenance procedures at the reserve fleets where those ships are periodically repainted, but I do not know what the frequency would be, and this is, I would say, in the nature of cosmetic deterioration at this point in time.

Chairman ROTH. Thank you, Mr. Kiss.

Prior to today, the Navy has been unable to provide either this Subcommittee or the IG with a copy of a pre-award survey, claiming the documents cannot be located. In your statement, you refer to a pre-award survey. Do you have this document?

Mr. HONIGMAN. I do not have it with me, sir, but—yes, I am told that Mr. Kiss has it.

This is the pre-award survey with regard to Pennsylvania Shipbuilding.

Mr. KISS. Correct.

Mr. HONIGMAN. Yes, sir. I would be happy to submit it to the Subcommittee.[1]

Chairman ROTH. This raises a question. Why wasn't this made available, for example, to the IG when he made his investigation?

Mr. HONIGMAN. I am told by Mr. Hanson that the document was made available to the Subcommittee staff. Frankly, sir, I don't know why it wasn't given to the IG, but I will find out.

Chairman ROTH. It is obviously a very critically important part of the investigation, and it seems strange to me that it wasn't made available at that time.

Mr. HONIGMAN. Sir, I can only agree with you, and we will make sure that the IG has a copy of it.

Chairman ROTH. Now, does this pre-award survey involve both the technical as well as the financial investigation?

Mr. KISS. Yes, sir, it does.

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[1] The document referred to was marked Exhibit No. 16, and appears on page 214.

Chairman ROTH. Does the survey look at management's technical qualifications and all other relevant factors?

Mr. KISS. Yes, sir. The survey covers quality standards, production things, as well as financial.

Chairman ROTH. Let me ask you this question. Tuesday, we had testimony that documentation is consistently a problem and that the Navy is making an investigation to determine why this is the case. Now, that just seems to me unbelievable.

If somebody said in my office that we aren't keeping the files in an orderly fashion, I wouldn't undertake an investigation. You are the Deputy Assistant Secretary. Why can't documentation problems be corrected immediately? The investigation started about a year ago, as I understand it. Why is it necessary to undertake an investigation? Why isn't the problem addressed directly?

Mr. KISS. The review that is in process is a procurement management review. It is more than just an investigation of the filing.

I can't agree with you more that we all have every right to expect that the documents are retrievable and filed.

Not by way of an excuse, but I do understand this program has undergone a number of investigations and surveys. The documents are in a constant state of turmoil. They are being torn apart, furnished to people, and then attempted to be put back together.

With respect to the pre-award survey that I just handed in, I only got that within the past week myself, and apparently, it had fallen in the back of some files in a file cabinet and was not found.

Chairman ROTH. Well, all I want to underscore is that this is an impossible situation——

Mr. KISS. Yes, sir.

Chairman ROTH [continuing]. And a matter of real concern to me when the IG, who is charged by the Congress with making independent studies, can't get the papers necessary to make an investigation.

You said the pre-award survey was submitted to the Subcommittee. Was that the complete pre-award survey, and when was that submitted?

Mr. HANSON. Mr. Chairman, we initially, I believe, submitted the financial portion and then, subsequently, and I am not certain as to how long ago, but it was about 3 weeks ago, in that time frame, that we found the technical portion and submitted that to the staff members.

In addition, on Tuesday, I spoke with Mr. Vander Schaaf and told him that I would provide him with all these documents, and I have made arrangements to do so.

Chairman ROTH. Do you know, Mr. Hanson, why that wasn't made available to the IG?

Mr. HANSON. We were unable to locate it.

Chairman ROTH. Where was it located?

Mr. HANSON. I found it, personally. It was in a file drawer back behind the divider, and evidently, files going in and out, it had slipped behind that divider. The document is 10 years old, and there wasn't any call for it for so long that it was pushed to the back and eventually got behind this divider, and it was just lost.

Chairman ROTH. So it wasn't a question of there being a number of calls for it. You just didn't find the survey when you went through the files.

Mr. HANSON. That particular document, that is correct, Senator.

Chairman ROTH. Mr. Honigman, prior to awarding the contract, did the Navy advise Penn Ship regarding concerns over the company's financial condition?

Mr. HONIGMAN. I think I would like to ask Mr. Hanson to respond to that, sir.

Chairman ROTH. Mr. Hanson?

Mr. HANSON. Mr. Chairman, there were discussions with Penn Ship as to the nature of their bid. There were concerns, and at one point, I believe they were asked if they could provide some assurance that would help the Navy allay these concerns with regard to their finances, and Penn Ship at that point offered the trust indenture.

Chairman ROTH. Let me ask you this. Did Penn Ship ever disclose to the Navy that it had guaranteed certain debts of Penn Ship's parent company totalling $4.2 million?

Mr. HANSON. I don't believe they had, no, sir.

Chairman ROTH. Isn't this information that directly relates to Penn Ship's financial condition?

Mr. HANSON. Yes, sir, I would say so.

Chairman ROTH. Now, if you had that information or had that information prior to the award, would that have affected the award?

Mr. HANSON. Well, that is a difficult question to answer. Knowing what I know now, I certainly would not, but I spoke with the contracting officer recently about that same circumstance, and his view was at that time—I believe we were talking in terms of a $5 million loan that someone had suggested may have been—that Penn Ship may have been liable for, would that have made a difference, and his view was that probably not, but once again, a difficult question to answer 10 years later.

Mr. HONIGMAN. But the real point is they had an obligation to tell the Navy, and they didn't do it.

Chairman ROTH. Now, given the Navy's concern regarding Penn Ship's financial stability, did the Navy receive any security from Penn Ship in order to facilitate the award of the contract?

Mr. HANSON. As I said earlier, Penn Ship offered and we accepted a trust indenture as part of the consideration for the award of the contract.

Chairman ROTH. Who drafted the trust indenture?

Mr. HANSON. That was drafted, I believe, by attorneys for Penn Ship.

Chairman ROTH. It was drafted by Penn Ship, and who reviewed it for the Navy?

Mr. HANSON. Our Office of Legal Counsel reviewed that.

They submitted an executed copy of this trust indenture, I believe, on or about the 15th of March, which was reviewed, and there were some issues that legal counsel had concerns over. These concerns were communicated to Penn Ship, and they submitted a later document dated 26 March that took into consideration the comments of legal counsel.

Chairman ROTH. To fully protect the Navy, the security agreements under the trust indenture had to be filed and perfected. Isn't that correct?

Mr. HANSON. To adequately protect the security, I would say yes, sir.

Chairman ROTH. Who in the Navy was responsible for ensuring this was done?

Mr. HANSON. I don't think that is clear. I would think that the contracting officer should ensure that that happens.

Now, he would have relied on legal counsel, but ultimately, he was given the document, and I would have to say that he should have made sure that the security interest was protected.

Chairman ROTH. Mr. Honigman, you are General Counsel.

Mr. HONIGMAN. I am the General Counsel.

Chairman ROTH. Whose responsibility would it be to see that these kind of documents are not only properly drafted, but properly filed?

Mr. HONIGMAN. As I understand it, the responsibility for filing the documents lay with the trustee itself; that is, the bank. The responsibility in the Navy for ensuring that that was done would have laid both with the contracting officer and with counsel.

I am also told, however, sir, that it is—and I am a litigator by trade, not a corporate lawyer—that it is not unusual to rely upon the trustee to fulfill his obligations, knowing that there is opportunity to obtain redress through litigation if he fails to perform his fiduciary duty.

Chairman ROTH. As General Counsel, would you recommend that policy?

Mr. HONIGMAN. No. I would recommend checking.

Chairman ROTH. It is my understanding that the trustee was responsible for protecting the Navy's fiduciary interest.

Mr. HONIGMAN. That is correct.

Chairman ROTH. Who was the trustee, and who chose the entity?

Mr. HONIGMAN. As I understand it from the file, the trustee was the Fidelity Bank, recommended by Penn Ship.

Chairman ROTH. Was the Navy aware that Fidelity Bank, the trustee, was also Penn Ship's bank?

Mr. HONIGMAN. I do not know.

I think we were aware because we had financial documents from Penn Ship, and I am certain that—I believe there was a revolving line of credit from Fidelity Bank. So I am confident that we did know that.

Chairman ROTH. Let me ask you, Mr. Honigman, again, as General Counsel. Does that make sense that the trustee be someone who is serving two masters?

Mr. HONIGMAN. Here, also, Mr. Chairman, my understanding is that it is not uncommon for the party whose assets are being encumbered to propose an institution to serve as trustee, even an institution with whom they have a relationship.

The institution here, as I understand it, was in the business of providing trustee services, but the better practice would have been to find a neutral trustee.

Chairman ROTH. So you would recommend against this policy?

Mr. HONIGMAN. Yes, sir, I would.

Chairman ROTH. Was the Navy aware that Fidelity Bank made loans to Penn Ship while acting as trustee for the Navy?

Mr. HONIGMAN. I do not know.

Chairman ROTH. Do you know, Mr. Hanson?

Mr. HANSON. I don't know specifically, Mr. Chairman.

Chairman ROTH. At the time of termination of the contract, did the Navy make any effort to determine whether there were any lien holders ahead of the Navy on assets secured under the trust indenture?

Mr. HANSON. Mr. Chairman, I believe that when we terminated the contract, it was our view that we were entitled to $20 million under the trust indenture, and that the drydock would have fulfilled that amount or roughly fulfill that, and that the negotiations went forward with that in mind.

Chairman ROTH. Let me ask my question again because I don't think you were responsive. At the time of termination, did the Navy make any effort to determine if there were any lien holders ahead of the Navy on assets that were secured under the asset agreement?

Mr. HANSON. I know of no reviews where we went to see how the situation—if it had changed since the receipt of the trust indenture.

Mr. HONIGMAN. However, Mr. Chairman, we will take that question and respond.

[The information follows:]

Although the Navy was in possession of documents concerning liens against the assets of Penn Ship, it was the belief of the Contracting Officer that the Navy was entitled to $20 million under the trust indenture which had been satisfied by the forfeiture of the Penn Ship floating dry dock. Therefore, the Navy's position with regard to lien holders was not specifically investigated.

Chairman ROTH. All right.

As early as November 1986, the Defense Contract Audit Agency concluded that Penn Ship would run $37 million over budget for the three oilers under contract. Yet, only 90 days later, the Navy awarded Penn Ship the contract option for a fourth ship. Why did the Navy make that award, and who was responsible for that decision?

Mr. HANSON. The second option was exercised, I believe, in February of 1987. At that point, that was, I think, 21 months after the contract was awarded.

My view is that, at that point, we didn't have indications that Penn Ship was in the financial condition that they ultimately were. Likely, they weren't in that condition. They were going to overrun the target, but I think we contemplated that when we awarded the contract.

Chairman ROTH. You contemplated when you awarded the contract that Penn Ship would run $37 million over the budget?

Mr. HANSON. No, sir, would overrun the target price. This was a fixed-price incentive contract where there was a hearing arrangement between target and ceiling.

Chairman ROTH. But is that bargaining in good faith, to bargain a sum, a ceiling that you felt was going to be violated? Does that make sense?

Mr. HANSON. No, sir. We did not think the ceiling would be violated. We had a target, and our view was that between the target and ceiling was where Penn Ship would ultimately wind up in terms of cost of performance.

Our liability was at ceiling. Many, many contractors overrun target price, and at that point, it is a sharing arrangement, and in this case, it was a 50/50 basis. Every dollar spent over target was a 50/50 share.

Mr. KISS. Mr. Chairman, the target price is a combination of the target cost.

Chairman ROTH. Yes, I understand.

Mr. KISS. I am sorry. I was trying to clarify.

Chairman ROTH. On November 15, 1988, the Navy received a letter from Penn Ship threatening bankruptcy if demands were not met. Isn't it true that shortly after receiving this letter, the Navy agreed to pay Penn Ship $10 million in advance payments?

Mr. HANSON. Yes, sir, that is true.

Chairman ROTH. How was the $10 million advance payment disbursed?

Mr. HANSON. We actually had approval to pay $17 million in advanced payments. We took $10 million and we entered into a memorandum of agreement with the company which included restrictions on compensation to corporate officers. It restricted their ability to enter into mergers or acquisitions.

We also set up a special bank account where funds were paid into the bank account and disbursements would be made with the signature of a Navy official as well as the company.

Chairman ROTH. Isn't it true that the Navy paid a $25,000 debt of Penn Ship to United Way out of the $10 million advanced payment account?

Mr. HANSON. There was a payment to the United Way from that special bank account, yes, sir.

Chairman ROTH. The payment resulted from the fact that Penn Ship had spent the $25,000 that it had collected from its employees for United Way. Why would the Navy ever pay that bill?

Mr. HANSON. It was our view that Penn Ship was having great difficulty in paying vendors and in making payroll, and likely, they used money that had come in to make payroll, and there weren't funds available to pay other legitimate obligations.

It was our view at the time that if these payments weren't made that any three of their creditors could band together and force Pennsylvania Shipbuilding into Chapter 11 or Chapter 7.

Chairman ROTH. Does that justify making payments to which Penn Ship was not entitled under the contract? Was Penn Ship entitled to be reimbursed or paid for the funds that had been collected from its employees?

Mr. HANSON. No, sir. That would not have been an allowable cost under the contract.

Chairman ROTH. So, whether or not it was experiencing financial difficulty, this was an improper payment.

Mr. HANSON. You might say that all the utility bills would not be entitled to under the contract either, but if we failed to make payments, if they didn't pay their utility bill and Philadelphia Elec-

tric shut off the power, then the work would not progress on the ships. So we felt that——

Chairman ROTH. Are you suggesting——

Mr. HONIGMAN. Mr. Chairman, if I may interject, you asked this morning what mistakes were made, and I mentioned mistakes were made in contract administration. This is one of them.

Chairman ROTH. All right. At termination, the Navy rewrote the lien on the floating derrick. Isn't it correct that the lien on the derrick was incorrectly filed in a courthouse in Chester, PA, instead of with the U.S. Coast Guard?

Mr. HONIGMAN. Unhappily so, yes.

Chairman ROTH. Who in the Navy was responsible for filing?

Mr. HONIGMAN. A junior lawyer in the Office of Counsel to the Naval Sea Systems Command, and I have checked, sir, and I am told that he was counseled as to his error, given some instruction in doing legal research correctly, to learn where to file liens, and that he has become a better lawyer.

Chairman ROTH. Why didn't the Navy seize the derrick to settle the additional amounts owed to the Navy?

Mr. HANSON. Mr. Chairman, it was our view that we had negotiated a settlement. It included the drydock, which likely was the extent of our entitlement under the trust indenture, but the settlement was broader than that. It included moving the ships out to a completion contractor. It included payments that Penn Ship would be liable for, and it was our view at the time that we had a chance of coming out of this pretty much even. So I think it wasn't felt that it was necessary nor would Penn Ship necessarily have agreed to including that derrick barge as part of the settlement.

Chairman ROTH. At termination, the Navy took possession of a drydock with an agreed-upon value of $19 million. Why did the Navy accept a drydock as payment?

Mr. HANSON. Initially, the drydock was given to us as security for the advanced payment, and one of the—probably the best reason was that that was an asset that Penn Ship was able to clear the liens on and give us an exclusive lien on that. Most of the other facilities were encumbered by other lienholders as well.

Mr. HONIGMAN. But I am told, Mr. Chairman, that it was the Navy's view that possession of a drydock would be an asset for the Navy; that there was a need for drydock capacity especially on a surge basis; and that what the Navy has done with the drydock has resulted in its being upgraded, maintained, and available for use if needed.

Chairman ROTH. Has the Navy——

Mr. HONIGMAN. Cash is obviously better, sir.

Chairman ROTH. Has the Navy ever used the drydock?

Mr. HONIGMAN. To my knowledge, it has not.

Is that correct?

Mr. HANSON. Yes.

The drydock is out on a lease arrangement to Metro Machine.

Chairman ROTH. Why didn't you take the derrick? That was lien-free?

Mr. HANSON. I think the drydock was an asset that we were interested in. I don't know that we had any designs on the derrick barge.

Chairman ROTH. Can the drydock be used by anyone at Penn Ship?

Mr. HANSON. It can be used anywhere, anywhere where there is sufficient depth of water to operate it.

Chairman ROTH. What does the Navy receive on lease payments on the drydock?

Mr. HANSON. The lease arrangement, I believe it is $450,000 a year, which is offset by any capital improvements, and as I understand, there were approximately $5 million worth of improvements. So, obviously, that offsets a number of years of lease payments, but they are capital improvements.

Chairman ROTH. Who made the improvements?

Mr. HANSON. I believe Metro Machine made those improvements.

Chairman ROTH. But the Navy received no cash?

Mr. HANSON. No cash, but the benefit of capital improvements to a piece of our equipment.

Chairman ROTH. After the contract was terminated the two ships remained at Penn Ship facility until they were taken to Tampa Shipyards. The Navy paid Penn Ship $45,000 per day and $90,000 on holidays to protect, preserve, and maintain the termination inventory.

Penn Ship received around $4.6 million to perform this task. What functions did Penn Ship actually perform to justify the $45,000-per-day payment, and who in the Navy was responsible for approving this payment?

Mr. Honigman?

Mr. HONIGMAN. Well, if I may answer that this way, sir, I am told—and I think that there was testimony this morning—that there were services actually rendered in marshaling equipment and protecting equipment.

The real issue here—and this is one of the mistakes I alluded to this morning—was why it took so long to take the ships out and why it took so long for the decision to be made as to where the ships would be sent. If that decision had been made in a timely manner, the Navy would not have been exposed to the $45,000 and $90,000 payments.

Senator McCain, we do have a vote going on. Do you want to try to start now?

Senator MCCAIN. Mr. Chairman, did it start at 2 p.m.? Maybe we ought to go over and come back.

Chairman ROTH. It just started. It is up to you.

Senator MCCAIN. I would suggest, maybe, to go over and vote and come back. Otherwise, I would have to just interrupt, but it is up to you, Mr. Chairman.

Chairman ROTH. The Subcommittee will be in recess.

[Recess.]

Chairman ROTH. The Subcommittee will please be in order.

Mr. KISS. Mr. Chairman, if I may, just to clarify the technical pre-award survey that I provided earlier, we thought that it had been delivered to the Senate staff. It appears that they never re-

ceived it, and we would look into that and make sure that you have a copy for the record.

Senator MCCAIN. What is it?

Mr. KISS. This was the pre-award survey that was missing.

Senator MCCAIN. Maybe you can tell us a little about it.

Mr. KISS. About the pre-award survey?

Senator MCCAIN. Yes. Does it recommend the——

Mr. KISS. Yes, it does. It recommended an award.

Senator MCCAIN. To Penn Ship?

Mr. KISS. Yes, it did.

Senator MCCAIN. No caveats?

Mr. KISS. No caveats in the technical pre-award survey.

Senator MCCAIN. Interesting.

Let me just, if I could for the witnesses, review very quickly the chronology of events, as I understand them, and it might be beneficial for the record.

In 1982, Penn Ship submitted their proposal. In 1984, the Navy decided to build more oilers, and obviously, as we know from the record, there were five companies that bid, and Penn Ship was the lowest bidder.

Please stop me, Mr. Honigman or Mr. Hanson or Mr. Kiss, if I misstate the case here.

Mr. KISS. I am not sure what you meant by 1982. 1982 was the original solicitation for the first four ships of the class.

Senator MCCAIN. Yes, right.

Mr. KISS. Yes, sir.

Senator MCCAIN. And the contract was given to Avondale.

Mr. KISS. Yes, sir.

Senator MCCAIN. OK. Thank you for clarifying that.

Some people concluded at that time that the Penn Ship price was unreasonably low. Obviously, we now have the pre-award survey, that did not indicate that.

Is this true, Mr. Honigman, that some Navy officers opposed giving Penn Ship any oiler contracts arguing that the company's bid of $222.4 million for two ships was too low?

Mr. HONIGMAN. Let me ask Mr. Hanson.

Mr. HANSON. Senator, I am sorry. I didn't hear the first part of the question.

Senator MCCAIN. Some Navy officers opposed giving Penn Ship any oiler contracts arguing that the company's bid of $222.4 million for two ships was too low.

Mr. HANSON. I don't have any specific knowledge of that.

Senator MCCAIN. OK.

Mr. HANSON. But we will take that for the record, sir.

[The information follows:]

There is no evidence that indicates opposition to the award to Pennsylvania Shipbuilding Co. on the basis that the bid was too low. There existed concern as to the aggressive nature of Penn Ship's bid; however, this concern was reviewed and considered by the Contracting Officer in the award decision.

Senator MCCAIN. Then later, the contract was modified with Penn Ship. It called for a firm fixed price of $331 million, $108.9 million more than the original contract. Is that correct? In June of 1988.

Mr. HANSON. That is when the first two ships were sent to Avondale, and the contract price was not increased. We recognized what our ultimate liability for the four ships would be carved out to Avondale, and what remained was $331.4 million.

Senator MCCAIN. On August 28, 1989, the contract modification terminated the T–AO contract with Penn Ship for default. The contract was terminated because Penn Ship was unable to complete performance under the terms and conditions of the contract, primarily due to the lack of financial resources. Is that basically a true statement?

Mr. HANSON. Yes, sir.

Senator MCCAIN. The Penn Ship witnesses this morning claimed that they were 91 percent done, completed on one ship and a significant percentage of the other, and that they could have gone ahead and completed it. What is your response to that assertion?

Mr. HANSON. In retrospect, if we had given them more money, they likely could have. That is my own personal opinion.

Senator MCCAIN. Well, in your personal opinion, should we have given them more money?

Mr. HANSON. In retrospect, we may have gotten those ships cheaper if we had, but we were under no obligation, and that was not the approach that we took. We had no legal basis to give them more money at the time.

Senator MCCAIN. Mr. Honigman or Mr. Kiss, please feel free to weigh in if you feel——

Mr. KISS. Again, it is opinion, but I think at that time it would have been a mistake for us to give them more money, even if the outcome would have been less costly, in hindsight, than it ultimately ended up. Primarily, I say that from the standpoint that there were terms and conditions associated with the contract, and I think it was incumbent on the Navy to try to enforce those terms and conditions, and if there were not grounds to give them more money, we should not.

Mr. HONIGMAN. Senator, this morning, I suggested that one of the mistakes that we made was going to Tampa. Probably, the mistake here was not in continuing with a contractor that couldn't perform, but in not going to Avondale who was able to perform and demonstrated the capacity to perform.

Senator MCCAIN. I guess, perhaps, that is one of the conclusions that many would draw is that Avondale could have completed the contract with relative ease rather than Tampa. Is that a logical assumption, I would ask? Mr. Hanson?

Mr. HANSON. Yes, sir, I think so.

Senator MCCAIN. Mr. Kiss.

Mr. KISS. I think relative to Tampa, it would have been easy, yes.

Senator MCCAIN. I mean, you would have had some confidence that the ships would have been completed?

Mr. KISS. A great deal more confidence, yes, sir.

Senator MCCAIN. Thank you.

As we talked about a couple days ago, in December 1988, Secretary Ball writes to Congress stating the closure of three shipyards, Penn Ship, Bethlehem Steel, and Tampa, but would have only a minimal impact on the shipbuilding industrial base.

November 21, 1989, the St. Petersburg Times said, "But will the $49 million contract that was announced be enough to turn around the ailing shipyard or is it just enough to temporarily staunch the flow of red ink?" I think the St. Petersburg Times was probably referring to the fact, as testified earlier, that the shipyard had been losing money for the previous 3 years.

Was this a consideration, and was the objections as voiced by our first two witnesses—or Captain Klein, one of our first witnesses, who said that he was convinced at the beginning that Tampa could not successfully complete the work on these ships?

Mr. KISS. The basis for the award for Tampa, as you have mentioned, was the justification that was prepared that basically reversed the finding that was talked about by Secretary Ball in his earlier letter, and it concluded that the situation had changed with respect to the shipyards that were in the auxiliary shipbuilding business. There was increased risk as to how many would be there for prospective future competition. There was the possibility of additional ships.

The sealift ships that Congress had been starting to initiate action in could saturate the shipbuilding industry for that ship, and that award of these contracts for two could possibly bridge Tampa for a couple of years. It certainly was not going to make that shipyard a long-term survival, and in that couple of years, the industry situation would shake it out and the Navy would have a better insight as to what would happen in the future.

If Tampa won business as a result of that 2-year interval, perhaps they would still be a viable shipyard.

Senator MCCAIN. So, in your view, the factors that drove the decision were as you just articulated?

Mr. KISS. Yes.

Senator MCCAIN. Is there a chance that there may not be a sufficient capacity in another shipyard? They may be able to bridge their viability for a certain period of time? What else?

Mr. KISS. Those are primarily the ones. It was recognized it was a short-term potential for Tampa.

Senator MCCAIN. Now, there were no other factors, you believe, involved in that decision?

Mr. KISS. None that I am aware of, sir.

Senator MCCAIN. In your personal opinion, were there any other factors?

Mr. KISS. I don't have any reason to believe there were any other factors. No, sir.

Senator MCCAIN. In August 1990, Arthur Andersen and Company attached an unusually pessimistic letter to the company's most recent annual report. The accounting firm said the company could not maintain its credit agreements and expects that additional cash will be needed to sustain its operation in the upcoming years. These factors raised substantial doubt about the company's ability to continue as a going concern. Did that have any impact on the Navy's thinking?

Mr. HANSON. Yes, sir. We were concerned about that, and as a result, we retained Coopers and Lybrand to go in and do a review, and basically, their recommendation was that these T–AO's should provide enough revenue to keep the company open. They would ob-

viously need new work in the future, but that is the case with any shipyard.

Senator McCain. In 1991, according to a St. Petersburg Times' article: "If Tampa Shipyards were a large company, its bid would have been thrown out."

I understand that Tampa Shipyards met, shall I say, the literal requirements for a small business. Do you think that that was the intent of Congress for them to be a small business?

Mr. Honigman. Senator, they were a significant shipyard preforming significant work on two big ships for the Navy.

I can't speak for what the intent of Congress was in how Congress defined a small business in its statute, but what I can say is the Navy found that they were not a responsible bidder for the TAGOS ship. Tampa had the right to a review of that by the Small Business Administration, who directed the Navy to disregard responsibility in reviewing their bid.

This is one where the Navy, I think, did the right thing in its judgment, and its judgment was reversed by somebody else.

Senator McCain. Namely?

Mr. Honigman. The Small Business Administration.

Senator McCain. Maybe one of the things we ought to do, Mr. Chairman, is look at who qualifies as a small business, and I am not sure small businesses are in the business of building ships, anyway, but I think by nature of the avocation that it would require a big business.

In August 1992, the Navy determines there is no basis for granting Tampa relief under Public Law 85–804. The Navy determined that Tampa's continued performance was not essential to national defense, even if the request was approved that Tampa could not complete the work.

Tampa Shipyards, at that time, their contract was terminated. Is that right?

Mr. Honigman. Not in 1992, sir. In 1993.

Senator McCain. OK. All right. Thank you.

Then Tampa Shipyards and the Navy disagree on the crane ships contract. I asked the other witness, and he didn't seem to know. Tampa asked for $13 million in relief. The Navy offers $1.2 million, and Tampa discusses settling the case out of court for $3 to $4 million. The Department of Justice and Navy do not agree and prepare the case for court. Is that an accurate description?

Mr. Hanson. That was MARAD, Senator.

Senator McCain. Yes.

Mr. Hanson. They had a dispute with the Maritime Administration, and I know that MARAD has made an offer in the range of a million dollars, and I knew that someone who had worked for me had contacted MARAD, and I knew that there was an offer, a counter-offer from Tampa, but I can't recall what that was.

Senator McCain. Does $3 to $4 million sound in the ball park?

Mr. Hanson. Much close than $13 million, yes, sir.

Mr. Honigman. But please let us emphasize that MARAD was not the Navy. It was, again, another agency.

Senator McCain. I understand that, but I am told that people in the Department of Justice and the Navy and MARAD were all as-

tounded when they heard that Congress appropriated $13 million to settle the TAGOS crane ship contract. Is that true?

Were you surprised, Mr. Hanson, when you heard that?

Mr. HANSON. Frankly, yes, I was.

Senator MCCAIN. Mr. Kiss.

Mr. KISS. Yes.

Senator MCCAIN. Astonished?

Mr. KISS. Not astonished because I didn't know all the details of the crane ship contract, but I was surprised.

Senator MCCAIN. Then, also, in that same Appropriations Act, an additional $45 million, an increase in the cost for completion of the ships, from $59.6 million to $104.6 million, and essentially overriding the Navy's August 7th decision. On August the 7th, it is my understanding, the Navy decided if they would not agree to any request for additional money from Tampa that they were prepared to go to court in conjunction with the Department of Justice. Is that correct?

Mr. HANSON. I am not sure I am following the time frame. Is this right before the appropriation?

Senator MCCAIN. I believe in August was the time, at least according to this record I have. The chronology I have is it was in August when the Navy said——

Mr. KISS. That is when we turned down the Public Law 85–804 request, yes, and we felt that was not justified.

Senator MCCAIN. You were then prepared to litigate if that was what was necessary.

Mr. KISS. Yes, sir.

Senator MCCAIN. The Department of Justice was in agreement with you since they obviously have to be involved in that.

Mr. KISS. There was a going contract. I don't think the Department of Justice was involved yet. We refused to make any extraordinary payments to Tampa, and then the contractual terms would have had to take their course of action.

Mr. HANSON. This was a year prior to the termination for default. At that point, we refused to pay the extra $24 million, and we told them that they needed to get on with performance and that we would be monitoring them.

Senator MCCAIN. So were you then surprised along with the $13 million that they got $45 million?

Mr. HANSON. I was, yes, Senator.

Senator MCCAIN. Did you have any confidence at the time that they would then be able to complete the ships?

Mr. HANSON. At that point, we were looking at a $58.3 million boost to the company, and I must say, at that time, although I didn't have confidence in the shipyard, with that additional money, I was torn. I thought they should have been able to. I mean, that is a considerable amount of money, twice what they asked us for originally. So they should have been able to do it, but my own private personal opinion was that we hadn't had any success to that point, and it wouldn't surprise me if they weren't able to from there.

Senator MCCAIN. So you believed that, even though the Congress overrode the recommendation to the Navy, the clear distinct message in the judgment of the Navy was that even with that infusion

that they would not complete the ships, which obviously turned out to be the case.

Mr. HANSON. That was my own personal feeling, although I felt that with an additional $58 million, they certainly had a much better chance than they did before.

The $45 million number, when we reviewed the Public Law 85–804 request, my feeling was that they would need something in the range of $45 million to be able to complete.

Senator MCCAIN. But they didn't.

Mr. HANSON. But they didn't; that is right.

Senator MCCAIN. Why not?

Mr. HANSON. At that point, they had severe problems with vendors. It wasn't even cash on delivery. Some cases, they had to make payment in advance. The people wouldn't bring their trucks around. They still didn't have the infrastructure that they needed to run the shipyard. They had lots of problems that they were never able to correct.

Mr. HONIGMAN. Senator, the reasons that we offered for the termination for default in August of 1993 included insufficient progress to support the contract delivery dates, and it is important to bear in mind, I guess, that this is also a mistake that the Navy needs to own up to.

We had extended their delivery dates four times. There was an inability to develop and adhere to an integrated schedule, a severe inability or unwillingness to create the infrastructure for management that was necessary, a shortage of working capital, an inability at the time to obtain test personnel to conduct tests or sea trials, a lack of on-board or spare parts, and finally, what Mr. Hanson has referred to, vendors who would only perform work after being paid in advance.

Senator MCCAIN. Was that roughly the same situation a year earlier in August of 1992?

Mr. HONIGMAN. That, I can't speak to myself.

Mr. HANSON. The problems were very, very similar, yes, sir.

Senator MCCAIN. Why in 1993, Mr. Honigman, after the infusion of—was it $12 million? I am not sure how much. They still had a shortage of working capital.

Mr. HONIGMAN. Mr. Senator, I can't respond to that question. That is probably a question that Tampa could respond to, but I cannot.

The fact is that in the Navy's judgment, they lacked sufficient working capital.

Senator MCCAIN. Mr. Hanson, when the $45 million bailout—and I will conclude with this—when the $45 million bailout or $58 million bailout was appropriated by Congress, there must have been some raised eyebrows around where you work. Is that true?

Mr. HANSON. Yes, sir.

Senator MCCAIN. And there must have been some speculation as to why this happened.

Mr. HANSON. I would have to say yes. Captain Klein—you know, everybody reads the newspapers, and there were probably offhand comments made.

Senator MCCAIN. But you have no specific knowledge or even general knowledge of anything untoward that was done?

Mr. HANSON. No, sir.

Senator MCCAIN. Mr. Chairman, could I just say, I want to thank you for holding this hearing. I think it is important. I think all of us, like you and I and Members of this Subcommittee, are strong supporters of a robust national defense, even in the post-cold war era.

I am not exactly sure what we need to do to make sure this doesn't happen again because, unfortunately, we have seen some of these before, not on a scale like this, but certainly we have seen things like this before.

I would suggest one of the areas is who qualifies as a small business, and I would suggest another one is this defense industrial base argument has never been valid, in my view. Especially, it was not valid in this situation, and it was used as an excuse, I think, for not awarding the contract to the most capable and qualified shipyards.

I again take exception to the allegation made by our friend, Mr. Vander Schaaf, on Tuesday that no one is responsible. There are people that are responsible, and I believe that we should find out who those people are who are responsible, wherever they may live and work.

I thank you, Mr. Chairman. I thank the witnesses.

Chairman ROTH. Gentleman, I thank you for being here.

I do want to emphasize how important I think it is that the rules be modified so that it is clear someone somewhere in the Pentagon can be held accountable for a contract. It is important that people be held accountable so that if they do a good job, they ought to be rewarded. We ought to provide incentives for an excellent performance. On the other hand, if someone fails, if the contract is a failure, as we have seen a whole series of here, then someone should pay a penalty.

There is no accountability, as I see it, in the system as it now stands, and I urge you gentleman as key leaders in the Pentagon to look at this problem because I think, together, we have to make the kind of reform that is going to provide the accountability that will mean a change in the culture of acquisition in the Pentagon.

Mr. HONIGMAN. Mr. Chairman, if I can just respond to one point you have made about accountability, we are accountable. I am confirmed by yourself and your colleagues. I have colleagues at the Navy, who are leaders, who are also accountable to the people and to the Senate.

I think I should emphasize to you that this has been a flawed procurement process. It is a process that has lessons that we are trying to learn, lessons that will teach us to do our business better, and that we believe in accountability, and we believe in rewarding excellent behavior as well.

We thank the Subcommittee and yourself very much for eliminating this situation for us, and we hope that in the decisions that we make, we will meet your standards.

Chairman ROTH. I can't emphasize too much, I am not talking about collective accountability. I am talking about someone somewhere in the chain assuming responsibility for a contract, and I think such accountability is what we ought to be working towards.

Gentlemen, we may have additional questions to submit to you in writing. We thank you for being here today. We thank you for your patience.

Thank you, gentlemen.

Mr. HONIGMAN. Thank you, sir.

Chairman ROTH. I am submitting a list of exhibits to be included in the record, and we will keep the record open for a period of 30 days for additional material.

[The list of exhibits appears in the Appendix.]

The CHAIRMAN. The Subcommittee is in recess.

[Whereupon, at 2:43 p.m., the Subcommittee adjourned.]

APPENDIX

Statement by
Derek J. Vander Schaaf
Deputy Inspector General
Department of Defense

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to be here today to discuss Navy contracting problems involving the Henry J. Kaiser Class (TAO-187) oiler program. Those problems principally involved hull numbers 191, 192, 194 and 196, which comprised 4 of the 18 ship program and part of the second shipbuilding increment, which the Navy refers to as a "flight." After the original contract for the four ships with Pennsylvania Shipbuilding Company was terminated for default, two of the vessels were completed by Avondale Shipyard, Incorporated, and delivered to the fleet. The other two, however, were turned over to Tampa Shipyard, Incorporated, which was unable to perform and was terminated for default.

The end result was that the Navy paid two contractors about $400 million for two oilers, TAO-191 and 192, which were never finished to a usable state and now ride at anchor in the James River.

I cannot recall another program where two prime contractors were terminated for default on successive contracts for the same work. It is highly appropriate for the Congress to inquire into this unfortunate and wasteful matter. I hope we can, at the very least, glean some lessons from it.

Incomplete Contract Files

In response to a complaint to the DoD Hotline, in 1993 we performed an audit of the procedures used in awarding contracts for the four oilers. Before summarizing our findings, I want to comment on a systemic problem regarding Navy shipbuilding contract management. The Navy internal management control structure for awarding major contracts--the business clearance process--is excellent in concept. Unfortunately, the controls can be badly compromised and accountability can be lost when the rationale for decisions is undocumented and contract files are negligently maintained. The Naval Sea Systems Command has been severely criticized by various oversight organizations since the early 1980's for lax contract records management; examples of those criticisms are at Appendix 1 to this statement.

To address the overall problem of contract file documentation at the Naval Sea Systems Command, the Assistant Secretary of the Navy for Research, Development and Acquisition agreed in response to our March 1994 report on the oilers to conduct an internal review of shipbuilding contracts to ensure that:

- preaward evaluations and business clearance memorandums properly support the contract award,

- business clearance memorandums reflect preaward evaluations, and

- contract files are properly documented and support the contract award.

The Navy review was originally scheduled for FY 1994, but it will not be completed until May 1995--this month. Improving internal Navy management discipline is vital if the business clearance process is to be fully credible. This is far more important than simply "papering files" or complying with obscure regulations on record keeping. Therefore we intend to press the Navy to take meaningful action. We will closely review the results of the agreed-upon self assessment and corrective action plans. In all future audits of Navy contracting matters, we will pay particular attention to file documentation related to the business clearance process until it is clear that the problem is solved.

In the case of the Kaiser class oiler contracts that we audited, missing documents definitely hampered our ability to ascertain all of the facts and pinpoint responsibility. Hopefully some of the missing documents or equivalent information will yet be unearthed during continued inquiries on this subject.

Contracting Actions for Oilers

The first four Kaiser Class oilers were placed under contract in 1982 and 1983 with Avondale Shipyards, Incorporated, after competition between six firms. In 1984, the Navy solicited target price proposals for nine more oilers and five shipbuilders responded. Four of the best and final offers were clustered very near the Navy independent cost estimate and between $1.0 billion and $967 million. The fifth proposal, which came from the Pennsylvania Shipbuilding Company (Penn Ship), was $820 million. The Penn Ship low bid was 15 percent below the next lowest offerer and 17 percent below the average for the other four offerers, all of which were far more experienced in new construction than was Penn Ship. The Navy subsequently decided to split the award, with four of the nine oilers going to Penn Ship. The best and final offer target price proposal from Penn Ship for the four oilers was $414.5 million. The proposal from Avondale, the designer and builder of the first four ships of the Kaiser Class, for the same four oilers was $455.0 million, about 9 percent higher.

Warning Signals Ignored

Mr. Chairman, throughout the existence of the Office of Inspector General, DoD, we have been advocates of the benefits of full and open competition. To foster more competition, we strongly endorse the benefits of moving to commercial

specifications and standards whenever more stringent military requirements are not absolutely necessary. The procurement of the second "flight" of Kaiser Class oilers was made under almost ideal circumstances: there was cost experience from the first "flight" to draw on, competition was fierce among several potential sources and the ship was considered a low technical risk due to the extensive use of commercial specifications and standards. Nevertheless, the Navy made a series of highly questionable business decisions, starting with the May 1985 award of a contract to Penn Ship for hull numbers TAO-191 and 192 (target price $222.5 million), with options for TAO-194 (at $96.9 million) and TAO-196 (at $95.0 million). The options were exercised in February 1986 and February 1987, respectively.

In our view, the Navy took undue risk in awarding nearly half of the second Kaiser Class "flight" to a technically and financially marginal contractor. The resulting fiasco became almost a parody of the problems often attributed to a supposed Government mindset that the lowest bidder is by definition the best supplier or it is too much trouble to justify not awarding to the lowest bidder.

The various warning signals that were overridden by the contracting officer, and more importantly, his superiors in the Naval Sea Systems Command and the Office of the Secretary of the Navy, are discussed in our March 1994 report. I will merely reiterate our views that:

-- The Naval Sea Systems Command Cost Estimating and Analysis Division did their jobs well, advising the decision makers that the Penn Ship proposal was significantly understated, assumed an unrealistic production learning curve and showed overly optimistic labor hour and materials estimates. There is no indication in the April 1985 business clearance memorandum that this "adverse" information was even considered. If it was considered, it certainly was not discussed in the business clearance memorandum.

-- The Navy did a very poor job of documenting its preaward survey and decision making rationale, leaving reviewers several years later with understandable frustration and suspicion. During the audit, the Navy was unable to locate copies of the preaward survey documents that are referred to in the business clearance memorandum as supporting a positive responsibility determination for Penn Ship. To confuse matters further, the Navy claimed in reply to a 1991 Freedom of Information Act request for the same documents that a complete preaward survey was not considered necessary and only the financial analysis portion was done. According to Navy personnel interviewed by the auditors, the 1991 response was wrong.

-- The extraordinary measures taken by the Navy because of justifiable concerns about Penn Ship's finances were ineffective. First, a major public accounting firm (KPMG) was

hired to review the Navy preaward financial evaluation of Penn Ship. The public accounting firm did not take a stand against a responsibility determination, but it did identify numerous areas of concern. During the subsequent execution of the contract, Penn Ship encountered insurmountable problems in precisely those same areas. The Navy response to the independent review was first to consider requiring a performance bond and later to accept a trust indenture. The performance bond approach unfortunately was rejected as undesirable because of the delay that it would create; during the 1980's DoD frequently made grievous errors because of constant pressure to accelerate acquisition programs. The trust indenture was poorly conceived and never legally perfected and filed, but the Navy accepted that worthless document anyway. No one took the initiative to ensure it was perfected and filed. During the audit, the Navy admitted it would have received little or nothing, had it attempted to collect on the trust indenture. In our view, the trust indenture was no more than window dressing and it is hard to believe it was ever given any credence as a way to protect the Government's interest.

-- Exercising the Penn Ship contract option for the fourth oiler in February 1987 was questionable and placed the Government at further risk. By that time, Penn Ship was clearly in severe financial trouble.

Second Questionable Award

In August 1989, the Navy modified the Penn Ship contract, terminating it for default, cancelling the trust indenture and transferring title of a floating drydock to the Navy to satisfy liabilities from Penn Ship. Hull numbers 194 and 196 were reawarded to Avondale. At this point, however, the Navy made another controversial and questionable choice. On grounds of industrial mobilization base considerations, the Navy awarded a contract to complete hull numbers 191 and 192 to another financially unstable concern, Tampa Shipyard, Incorporated.

Hull numbers 191 and 192 were towed from Penn Ship in Chester, Pennsylvania, to Tampa, Florida, in 1990. At that time, the Navy estimated them to be about 85 and 65 percent complete, respectively. (Penn Ship uses higher figures.) Tampa Shipyard was unable to execute the contract, primarily because of financial reasons. Despite several contract modifications and special funding provided by the Congress in the Defense Appropriation for FY 1993 to enable the contract ceiling price to be raised from $49 million to $166 million, progress stalled. In August 1993, the Navy terminated the Tampa contract for default. The ships were never finished, although the Navy paid Penn Ship and Tampa over $400 million for them.

In 1993, the Senate Armed Services Committee requested the Inspector General, DoD, to provide feedback on how Tampa Shipyard and another contractor used certain "get well" funds from the FY 1993 Defense Appropriation. We reported back in an October 1993 report, Contractors' Uses of Additional Funds Appropriated for Three Navy Shipbuilding Programs. We found nothing untoward in that narrowly focused review.

Other Actions

There have been lawsuits, including qui tam actions, claims and counterclaims, and allegations of criminal activity by parties related to Penn Ship and the Kaiser Class program. Those matters either do not relate directly to the Department of Defense or concern aspects that have been reviewed by the Naval Criminal Investigative Command, not by my office.

Summary

Many of the ongoing DoD acquisition reform initiatives are intended to drive down costs by attaining more competition, chiefly by using commercial practices and avoiding unduly restrictive specifications, standards and other contract requirements. The Kaiser Class program shows us, however, that competition is not a panacea. Government contracting officials need the authority, will, competence and support from superiors to protect the taxpayers' interest by taking the heat for not

awarding contracts to lowest bidders that cannot meet reasonable financial and technical criteria. The Navy business clearance process provides a good framework for decision making, but no process is infallible. Other work by my office related to contracts awarded to marginal contractors is summarized at Appendix 2 and shows that other DoD components have had similar problems. Granted, we are discussing these matters with the benefit of hindsight; however, I am disturbed that the Navy response to the audit acknowledged little if any error.

This concludes my statement and I would be happy to take your questions.

Appendix 1

Examples of Poor Contract Documentation Discipline

1. During the audit of the allegations involving the Kaiser Class contracts, auditors from the Office of Inspector General, DoD, reviewed 17 Navy shipbuilding contract files that were eventually found to be unrelated to the matters in question. The contracts were awarded from 1988 through 1992. Seven (41 percent) of the Business Clearance Memoranda were missing. Six files (35 percent) contained no documentation on the preaward evaluation. Others contained references to, but no copies of, DCAA reports and financial capability reviews.

2. In October 1994, the Office of Inspector General, DoD, issued Report No. AFU 95-01, Contract Audit Followup Compliance in the Navy Supervisor of Shipbuilding, Conversion and Repair (SUPSHIP) Offices. The report summarized reviews at eleven SUPSHIP offices, which are under the Naval Sea Systems Command. Contract audit followup efforts at most sites were achieving reasonable results; however, contract file documentation concerning the disposition of audit advice was deficient at four offices.

3. In August 1992, the Office of the Assistant Secretary of the Navy (Research, Development and Acquisition) completed a procurement management review of the Naval Sea Systems Command. The resulting report commended the Command for its positive attitude toward correcting various problems, which included the following:

"NAVSEA's files have, in the past, been unsatisfactory. Reviewers such as GAO or IGs would preface their reports with mention of the poor files. Aside from the disorder, duplication, and erratic content of the file folders, the file room was frequently unable to locate files, because recent years' files were piled on the file room floor without any order. NAVSEA 02 has taken over management of the file room, and has made major improvements....

The content of the file folders themselves is also much improved, but here, as with many Navy contracting activities, further improvement is needed. The absence from the file of important documents like certificates of current cost and pricing data, procurement integrity certificates, and small business subcontracting plans noted elsewhere in this report is sufficiently common to suggest that contracting officers themselves would benefit from better-organized files prior to contract award. Both NAVAIR and SPAWAR have implemented procedures which are designed to ensure that the contract file is maintained in a standardized, orderly fashion so that the contracting officer (and, in NAVAIR's case, personnel responsible for a quality check before the file enters the file room) know where to look for each required document. NAVSEA should consider similar procedures. Post-award files are even more deficient, but improvement in this area may not have the same payoff in terms of better contracting."

The Office of Inspector General, DoD, does not agree with the doubts expressed in the Navy report about "payoff in terms of better contracting" from improving post-award contract file management. Also, we saw no indication during our review of shipbuilding contracts at the Naval Sea Systems Command that any kind of quality check had been instituted there in response to the Navy procurement management review.

Examples of Questionable Contracting Actions

1. In November 1994, the Office of Inspector General, DoD, issued Report No. 95-030, Procurement of the Target Holding Mechanism, Tank Gunnery, From Combined Arms Training Systems. The Army awarded a contract for target holding mechanism to a contractor with financial difficulties, no prior experience and limited technical ability. Eventually the contractor was terminated for default. The Army contributed to the problem by certifying a flawed technical data package, issuing 720 notices of revision on the contract and did not handle the contractor's request for equitable claims adjustments efficiently.

2. In April 1993, the Office of Inspector General, DoD, noted in Report No. 93-093, Procurement Procedures Used by the Single Manager for Conventional Ammunition, that contracts were awarded by the Army to financially distressed companies with high probability of bankruptcy and contract default. In a sample of 58 contracts, seven were reprocurement actions because of termination of eight defaulted contracts. Those eight contracts had $17.5 million in unliquidated progress payments. Accurate information on the contractors' financial status was available, but was not used by the contracting officers.

3. In April 1992, the Office of Inspector General, DoD, issued Report No. 92-073, Release of Morrison Knudsen Corporation from the Performance Guarantee on the AOE-6 Contract. In January 1987, the Naval Sea Systems Command awarded the contract for the lead AOE-6 Class ship, with options for three more ships, to the National Steel and Shipbuilding Company (NASSCO). Because the Navy was concerned about NASSCO's financial capability to perform the contract after an "aggressive bid," although no preaward survey documents could subsequently be located, a performance guarantee was made by NASSCO's parent company, the Morrison Knudsen Corporation. In 1988, Morrison Knudsen expressed the intention to get out of the shipbuilding business and petitioned the Navy for release from the guarantee. A discharge agreement was signed in April 1989. The auditors criticized the internal Navy processes used for consideration of the performance guarantee release issue and concluded the Navy did not obtain sufficient financial consideration from Morrison knudsen. The Navy agreed that more specific guidance on the placement, modification and recision of performance guarantees was warranted, but nonconcurred with the conclusion that more financial consideration should have been sought from Morrison Knudsen. The Navy also disputed the auditors' statement that Navy concerns about NASSCO's financial capability prevented the option for the fourth ship from being exercised under the favorably priced contract. The auditors stood by that assertion and noted the gaps and inconsistencies in Navy records pertaining to the basis for the crucial contracting decisions on this matter.

STATEMENT

CAPTAIN C.J. SCHRODT
UNITED STATES NAVY, RETIRED

Good morning, Mr Chairman and Members of the Subcommittee. I am Captain Pete Schrodt, U.S. Navy, Retired and I am an engineer educated at the University of Nebraska, MIT and Cornell University. I was commissioned in the U.S. Navy in 1965 and served in a variety of sea and shore tours. I have served on four ships, a tour in Vietnam as skipper of a patrol boat, one Naval shipyard, five Supervisor of Shipbuilding commands, and on the Chief of Naval Operations Staff. Of the five Supervisor of Shipbuilding tours, three involved new construction. I have had three tours of duty as Officer in Charge and two Commanding Officer tours. I retired with 36 years of service on June 30, 1992. I appreciate the opportunity to testify before you today regarding the Navy T-AO 187 oiler contract. For the record, I would like to submit my complete statement, which I will summarize in my testimony.

I took command of Supervisor of Shipbuilding Conversion and Repair in Brooklyn, NY, in July 1986. In August 1987, the Naval Sea Systems Command Procuring contracting officer transferred the responsibility for administration of the T-AO Class Shipbuilding Contract and all other government contracts with Pennsylvania Shipbuilding Company (Penn Ship) from Supervisor of Shipbuilding Conversion and Repair, USN, Portsmouth, Virginia, to Supervisor of Shipbuilding Conversion and Repair, USN, Brooklyn, New York. As a result, I became the "SupShip" in charge of this oiler contract that had been awarded to Penn Ship.

The Supervisor of Shipbuilding construction, conversion and repair, referred to as SupShip, is responsible for the administration and oversight of the U.S. Navy contracts awarded to private ship repair and shipbuilding firms in the SupShip's geographical area of responsibility. In addition, the SupShip also provides the procurement, administration and oversight of the repair of Navy ships for the fleet.

The initial contract, awarded May 6, 1985, was a fixed-price, incentive contract for two ships with original target prices of $123 million and $100 million, respectively, with options for two additional ships. During August and September 1987, I, along with my staff, conducted a technical and engineering review of the actual work ongoing on T-AO 191 (ship 1 of the contract). Based on this review, it was my opinion that Penn Ship did not have the artisans, technical and core competencies and related shipbuilding skills in sufficient quantity to build and deliver any T-AOs within the contract provision, time frame and price.

On October 14 and 15, 1987, I briefed the Commander Naval Sea Systems Command ("NavSea"), Vice Admiral Rowdin, regarding the status of the contract. On November 5, 1987, I provided the same briefing to the senior staffs for the Commander of NavSea and the Assistant Secretary of the Navy, Shipbuilding and Logistics, Everett Pyatt. My evaluation was that Penn Ship could not build and deliver any T-AOs within the contract provisions. I recommended the contract be terminated.

The NavSea Program Manager's T-AO Quarterly Review Conference was held at Penn

Ship during the week of November 17-21, 1987. Based on this conference and previous evaluations, I briefed Navy Assistant Secretary Pyatt's staff on December 22, 1987 I provided my evaluation that Penn Ship could not build and deliver any T-AOs within the contract provisions, and I again recommended termination of the contract

The week of March 1-4, 1988, I briefed the Commander of NavSea on the status of the contract, informing him that contractor costs were going up and progress was going down I informed Vice Admiral Rowdin that there was little chance the first ship would be delivered on time and that if it was delivered, it would be over-budget At this time, I was informed by the NavSea procurement contracting office that negotiations between Penn Ship and the Navy were ongoing to remove two ships from the contract.

By May 27, 1988, progress payments to Penn Ship exceeded the ceiling price on T-AO 191, the first ship. I advised Penn Ship that additional payments exceeding the contract price per ship may not be forthcoming. The procuring contracting office directed progress payments above the ceiling on the basis that the ceiling price of the contract did not apply to individual ships.

NavSea's Program Manager's T-AO Quarterly Review Conference was held at Penn Ship during the week of June 1-4, 1988. On June 16, 1988, NavSea announced the decision to transfer the third and fourth ships in the contract to Avondale Industries, Inc.

On June 27, 1988, NavSea's T-AO Procuring Contracting Officer conducted a contract conference at Penn Ship. The new, modified contracts with both Penn Ship and Avondale were fixed-price for the four T-AO ships formerly in the Penn Ship contract. The price and delivery schedules of these were modified. I have included specific details concerning these modifications in the statement I submitted for the record.

Before the Transfer

Hull Number	Ceiling Price	Delivery Date
T-AO 191	$145,243,934	March 6, 1989
T-AO 192	$117,683,251	December 6, 1989
Sub-Total	$262,927,185	
T-AO 194	$114,617,844	September 6, 1990
T-AO 196	$112,302,805	June 6, 1991
Sub-Total	$226,920,649	
Change orders adjudicated through June 16, 1988	$ 10,345,842	
Total	**$500,193,676**	

After the Transfer

PSC

Hull Number	Ceiling Price	Delivery Date
T-AO 191 & 192	$331,400,000	August 31, 1989 July 31, 1990
Non-transferable work (estimated) T-AO 194 & 196	$ 10,600,000	
Material (estimated)	$ 39,500,000	
PSC Total	$381,500,000	

AII

Hull Number	Ceiling Price	Delivery Date
T-AO 194 & 196	$216,000,000	September 6, 1990 June 6, 1991
T-AO 194 & 196 Material transferred from PSC (estimated)	$ 39,500,000	
AII Total	$176,500,000	
Grand Total PSC & AII	**$558,000,000**	

The new fixed-price contracts, plus estimated costs for non-transferable work, amounted to almost $58 million more than the originally negotiated total ceiling price and more than $143 million over the original total target price.

During the week of November 29 to December 2, 1988, I briefed the Commander of NavSea on the status of both ships. Penn Ship was not making the required progress and was significantly behind schedule to deliver either ship within the time frame and price of the

modified contract requirements. In fact, by this time, Penn Ship had practically stopped working on both ships, although an official "stop work" order was not issued until February/March 1989. My evaluation was that Penn Ship could not deliver either ship within the time frame and price requirements of the contract. My recommendation was to terminate the contract with Penn Ship for T-AO 191 and T-AO 192.

By late 1988, Penn Ship's progress toward completing the ships diminished dramatically, and the company's financial problems worsened. In an effort to extricate Penn Ship from these problems, the Navy approved an advance payment of at least $10 million. To maintain better control of these funds, they were placed in a special account that required Navy and Penn Ship co-signatures on checks drawn on that account. Penn Ship submitted several bills for questionable expenditures to be charged to this account. These included charges for new furniture for a home in Texas, and the costs of bulldozing work on the Texas property. Penn Ship also submitted a bill for payment of approximately $25,000 in United Way contributions that Penn Ship had deducted from employees' wages but never paid to the United Way. Another bill submitted for payment was for an employee's child support payments that were supposed to be deducted from the employees' salaries and automatically transferred to beneficiaries. Penn Ship deducted but did not transfer the money, resulting in the employee being in arrears with child support payments. My staff informed me that the Penn Ship employee was incarcerated for non-payment of child support. I rejected all of the above bills for payment.

My tour of duty as Commanding Officer, Supervisor of Shipbuilding, Conversion and

Repair, USN, Brooklyn, New York, was completed May 18, 1989 At that time, the status of T-AO 191 and T-AO 192 had remained unchanged since late 1988—the first ship was approximately 80 percent completed and the second ship only 50-60 percent completed I then took command of Supervisor of Shipbuilding, Conversion and Repair, San Francisco, California, effective June 1989.

In conclusion, it is unfortunate that it took two years to terminate Penn Ship's contract While both termination options, for default or for convenience, would have cost money, it would have been less expensive in the long run to terminate as rapidly as possible.

Thank you for the opportunity to testify before you I hope the information I provided makes this complex matter more understandable. I would be happy to answer any questions you may have.

STATEMENT

CAPTAIN KARL M. KLEIN
UNITED STATES NAVY, RETIRED

Good morning, Mr. Chairman and Members of the Subcommittee. I have been asked by your staff to appear before the Subcommittee, to make an opening statement regarding my background and my experience as the Supervisor of Shipbuilding administering the Navy's TAO and TAGOS contracts with Tampa Shipyards, Inc., and to answer your questions.

I am an engineer educated at the Naval Academy and M.I.T. I was commissioned in the U.S. Navy in 1964 and served in a variety of sea and shore tours devoted to the engineering, construction, operation, and maintenance of ships and submarines. My duty stations have included service on four ships; the Portsmouth Navy Shipyard in New Hampshire; the Naval Ship Repair Facility in Yokosuka, Japan; the staff of the Commander, Naval Surfaces Forces, Atlantic Fleet; and the Engineering and Planning Department of the Supervisor of Shipbuilding Office in Jacksonville, Florida. I headed the Naval Academy's School of Engineering from 1985-1989, and I was the Supervisor of Shipbuilding in Jacksonville (and Tampa), Florida, from October 1989, until my retirement in June 1993. Since retirement, I have been on the faculty of Bishop Kenny High School in Jacksonville.

When I assumed command in Jacksonville in October, 1989, I and my staff were aware that the Navy was considering Tampa Shipyards (a yard under my geographic area of

responsibility) for a possible contract to complete two partially constructed TAO-187 class oilers. In November, we were informed that a letter contract had been awarded for Tampa Shipyards to complete TAO 191 by November, 1991, and TAO 192 by July, 1992. We immediately put together the core of a project team to administer the contract. Within the Command, we had some corporate knowledge of Tampa Shipyards, none of it favorable. My first visit to the yard did little to relieve our concerns. While I found some of Tampa Shipyards' facilities exceptional and the enthusiasm of its president (Ralph Anselmi) and members of his staff high, I also found the yard generally filthy and littered with debris. I found no indication of an up and running management organization nor of the planning, scheduling or other software systems required to back it up. The company had also lost money in each of the preceding three years.

While I voiced my concerns informally to my superiors in the Naval Sea Systems Command (NAVSEA), there was nothing to be gained at this point in objecting to an awarded contract, so we concentrated our energies instead on getting the job off to as good a start as possible. The start could not have been worse. Enroute from Pennsylvania in December, 1989, Tampa Shipyards' towing contractor lost the TAO 191 and it ran aground on the coast of North Carolina. It was later refloated and, by February 1990, TAO 191 and TAO 192 were finally in Tampa. Damage to the 191 was significant, but it was repairable and fully insured.

Not much production progress ensued for the first several months as Tampa Shipyards was primarily engaged in moving not only the ships, but several hundred truck and railcar loads

of equipment and material down from Pennsylvania. By June, 1990, however, Tampa Shipyards had had enough time to establish a clear performance trend and it was not good. In June, we held our first Quarterly Progress Review (QPR) in which both Tampa Shipyards and SUPSHIP briefed representatives from NAVSEA and other interested commands. Tampa Shipyard's report was upbeat; ours was not. I followed up this and every QPR briefing with my own written assessment to NAVSEA. In that first report, I stated flatly that Tampa Shipyards would not meet the contract delivery dates, that the company did not have the management capability in place to comply with the contract, that Tampa Shipyards was unwilling or unable to devote the necessary resources to the project, and that, by every indicator available to me, Tampa Shipyards was in serious financial trouble and lacked the cash and credit resources to adequately perform the requirements of the contract.

By November 1990, it was patently obvious that Tampa Shipyards could not complete the contract on time. Mr. Anselmi was replaced as Tampa Shipyard president by Alan Nierenberg who, along with Tampa Shipyard's board chairman George Steinbrenner, requested a contract extension, additional money, and relief from several clauses of the contract. NAVSEA denied the request.

Tampa Shipyard's performance continued to deteriorate and by February, 1991, I projected a cost overrun of at least $6.5 million and reported that we saw no evidence that Tampa Shipyards had financing to cover the loss. Moreover, we did have strong evidence that Tampa Shipyards was delinquent in paying vendors for material and services (for which the

Navy had already paid Tampa Shipyards under the small business exception to FAR clause 52.216-7).

Tampa Shipyards had by now taken a clearly disputatious stand in the performance of the contract. Extravagant claims of delay and disruption were voiced by company officials and in a QPR executive session, Mr. Nierenberg informed the Navy that unless relief were granted under the "as is, where is" clause of the contract, Tampa Shipyards would not continue to devote a large amount of the company's assets to the project.

After lengthy negotiations, NAVSEA and Tampa Shipyards agreed in April 1991, to a contract modification (P-00012) which raised the ceiling price of the contract by $10.2 million, authorized a lump sum progress payment of $3.2 million, and extended the completion dates for TAO 191 and TAO 192 to May and December, 1992, respectively. Tampa Shipyards waived its claims and promised to bring delinquent vendor accounts current.

At this point, the situation worsened dramatically when the Navy was forced to award Tampa Shipyards a contract for the construction of TAGOS 23. NAVSEA, as part of its preaward survey of Tampa Shipyards, assembled enough financial data to conclude that the company would lose money on the TAGOS contract and had insufficient financial assets or credit to sustain the loss. The contract was awarded only after the Small Business Administration issued Tampa Shipyards a Certificate of Competency.

In June 1991, I reported that without a dramatic improvement in productivity (not then apparent), Tampa Shipyards would not complete the TAOs within the revised contract price or by the revised completion dates. I also reported that as of June 4, 1991, Tampa Shipyards' accounts payable aged report still exceeded $450,000 and that, based on informal complaints we had received from Tampa Shipyards' vendors, it was understated.

In August 1991, and again in November 1991, I reported evidence was accumulating that, despite the P-00012 change, despite the TAGOS award (which in the short term should have improved Tampa Shipyards' cash flow), and despite personal lines of credit from George Steinbrenner, Tampa Shipyards' financial condition continued to deteriorate and that its accounts payable aged report was growing (to $2.8 million by October). Tampa Shipyards' rate of production progress, previously insufficient to support the revised TAO completion dates, was also deteriorating.

For the next several months, progress on the TAOs was minimal while Tampa Shipyards put most of its assets on the TAGOS contract and on whatever short-term commercial work it could bring into the yard. Tampa Shipyards' financial condition continued to deteriorate and I reported steady increases in aged accounts payable up to $10 million. The company's FY91 financial statement showed five straight years of losses and contained the statement by its independent accountants that the company "... has given notice to its lenders of its failure to comply with certain requirements of its credit agreements. These factors raise substantial doubt about the company's ability to continue as a going concern."

In March, 1992, Tampa Shipyards formally acknowledged to the Navy its inability to meet the (revised) TAO contract delivery dates, a capital shortage impacting its ability to purchase material and equipment, and that "... a working capital infusion is required in order for us to complete construction of TAO 191/192 in a timely manner." NAVSEA issued Tampa Shipyards a "cure notice" on the TAO contract citing lack of progress and the continuing shortfall of necessary working capital. I released a "Bellringer" message alerting the Navy and Defense Department hierarchy of the distinct possibility of Tampa Shipyards' bankruptcy and the company's inability to complete either the TAO or TAGOS contracts. In that message, I reported "interest on the part of staffers from the House Appropriations Committee and several Congressmen (local and otherwise)." On May 26, 1992, Tampa Shipyards submitted to NAVSEA a request for extraordinary relief under Public Law 85-804.

In early June, 1992, Congressmen Murtha and Young visited Tampa Shipyards along with Mr. Dan Howard, Undersecretary of the Navy. A few days later, Mr. Gerald Cann, Assistant Secretary of the Navy, also visited Tampa Shipyards along with representatives of NAVSEA. At NAVSEA's request KPMG Peat Marwick reviewed Tampa Shipyard's financial condition and reported that as of June 15, 1992, past due accounts had risen to over $20 million. Mr. Steinbrenner also hired a consulting firm to review Tampa Shipyards' performance on the TAO contract. A copy of the consultant's report was provided to the Navy confirming our contention that Tampa Shipyards had not been properly managed, staffed, or organized to complete the contract. Shortly after the report was completed, Mr. Nierenberg was replaced as Tampa Shipyards' president by Stuart M. Novak. After a series of lengthy discussions with

Tampa Shipyards, NAVSEA, on August 7, 1992, denied Tampa Shipyards' request for extraordinary relief. The denial stated in part that even if Tampa Shipyards received the money requested, the company still might not be able to finish the ships. I and my staff made contingency plans to remove the ships and other Navy property from the yard in the event of bankruptcy.

Tampa Shipyards managed to hang on until October of 1992, when the FY93 Defense Appropriations Act directed the Navy to provide the company with extracontractual relief in the form of a $45 million upward adjustment to the TAO contract (including a $12 million cash payment). The Act also required the Maritime Administration to pay Tampa Shipyards $13 million in cash to settle a disputed claim on another, unrelated contract. NAVSEA negotiated contract revision P-00018 with Tampa Shipyards to fulfill the requirements of the Congressional mandate and extend the completion dates to February, 1994 (TAO 191) and October, 1994 (TAO 192).

Congressional action saved Tampa Shipyards from bankruptcy in 1992, but the Navy saw no benefit from the infusion of cash to the company because Tampa Shipyards still failed to put in place an adequate production, planning, material, subcontractor control, quality assurance, and test and trial organization. It failed to correct numerous production errors that had accumulated or to bring current its overdue accounts. Progress on the TAOs remained painfully slow and Tampa Shipyards was falling behind on its engineering and production schedules for TAGOS. By November, 1992, Tampa Shipyards had already incurred a cost overrun on the TAGOS

project of 16,700 manhours (57% based on 29,100 manhours earned)

By January 1993, Tampa Shipyards' financial condition had again worsened to the point that the company requested the Navy release $5 million in retentions on the TAO and TAGOS contracts to pay past due accounts with vendors and sub-contractors who had either stopped work or refused to ship material. The Navy agreed to exchange Tampa Shipyards' letters of credit for performance bonds to free up some working capital, but disapproved the release of retentions noting that it would constitute an "unusual progress payment." At this point (triggered by Tampa Shipyards' violation of several specific terms of the TAO and TAGOS contracts), I stopped progress payments and released my third "Bellringer" message, again advising the Department of Defense and the Navy that the company's eventual failure was likely.

By March 1993, Tampa Shipyards still had not produced an acceptable TAO progressing system as required by P-00018. In April, I finally received a progressing system I could at least provisionally approve and NAVSEA agreed to modifications on the TAO and TAGOS contracts that together freed some $7 million for direct payment to Tampa Shipyards' vendors and sub-contractors. However, in May, 1993, I reported that despite these cash infusions, my overall prognosis remained bleak. "Tampa Shipyards' high debt load, inadequate management, inefficient production, and exploited vendor base together represent too great a hurdle for the company to achieve sustainable profitability." Failure was inevitable.

In June 1993, I was notified by Tampa Shipyards that unless the Navy assumed

immediate payment for rental lift equipment used for painting and other drydock work, the vendor would remove the equipment which in turn would result in termination of affected work on the TAOs. On June 17, 1993, I released another Bellringer message reporting this latest development and reiterating my most recent prediction of Tampa Shipyards' ultimate failure. As planned, a week later I was relieved as Supervisor of Shipbuilding and retired from the Navy.

I hope this testimony is helpful in the investigation and if I have raised any questions, I will try to answer them to the best of my recollection.

STATEMENT OF
THOMAS C. WELLER, Jr. AND RONALD J. STEVENS
TO THE
U.S. SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

Mr. Chairman and members of the subcommittee, thank you for the opportunity to present the story of Pennsylvania Shipbuilding Company ("Pennship" or the "Company") and its demise in 1989 with the termination of the "Henry J. Kaiser" class T-AO contract with the U.S. Navy.

At the outset, we wish to state that we are sorry that Pennship did not complete the T-AOs that it contracted to build for the Navy. With the benefit of hindsight, we now know that certain of our assumptions on which we based our bid proposal, although reasonable at the time, were overly optimistic. But what is more unfortunate, is that with a little more assistance from the Navy at a crucial point in this contract, all the vessels would have been completed. As it was, two vessels were completed entirely at Avondale Industries in New Orleans, and the two vessels remaining at Pennship (T-AO 191 and T-AO 192) were delivered to the Navy 91% and 74% complete, respectively. Technically, there would have been no problem completing these vessels at Pennship. Financially, for a sum of money considerably less than that which the Navy ultimately spent after their departure, T-AO 191 and T-AO 192 would have been delivered by Pennship. As you consider this matter and Pennship's role, we urge you to keep the following points in mind, all of which will be discussed in greater detail in this statement:

1. A contract to construct fleet oilers (T-AO) for the Navy was awarded to Pennship in 1985 and subsequently terminated when cashflow problems prevented completion.

2. In preparation for this contract, Pennship assembled a management team with over 100

years of combined shipbuilding experience to prepare its bid. This team included Rear Admiral Charles Payne, USN (Ret.), Pennship's President, former President of Webb Institute, former Supship Pascagoula, Commander of Charleston Naval Shipyard and Comptroller of NAVSEA.

3. Pennship submitted an aggressive bid based on reasonable assumptions. The Navy determined the Pennship bid to be "within the competitive range," meaning it was realistic -- neither too high nor too low.

4. In addition to the Navy's own internal review of Pennship's corporate financial viability, the Navy retained the accounting firm of Peat Marwick to conduct an independent review of the Company as well as the contract pricing structure. Peat Marwick recommended that Pennship be found financially responsible, and determined there was no reason for the Navy not to award a T-AO contract to Pennship.

5. The failure of Pennship's bid assumptions to materialize was due largely to poor contract administration by the Navy and to other causes outside of Pennship's control.

6. The independent American Bureau of Shipping (ABS) reviewed Pennship's performance during the course of production, and approved and certified the progress of the ships.

7. Pennship could have finished building the ships with a modest amount of additional money and the cooperation of the Navy, which was the Navy's approach for other similarly situated contractors. This was confirmed in February, 1988, by an independent assessment by Advanced Technology (now PRC), which was retained by Pennship to review its T-AO program. This is the same consultant used by the Navy to review its destroyer construction program. The Advanced Technology team was lead by Rear Admiral William Wyatt, USN (Ret.) and included, among other retired Navy Officers, Vice Admiral Russ Bryan, USN (Ret.), former head of NAVSEA. They concluded after reviewing the T-AO program at Pennship the following:

> Overall, management knows what to do and how to do it. The shipyard has a long history of ship construction and repair and many experienced key personnel from years past remain in the shipyard.

8. When the Navy decided it did not want to complete the vessels at Pennship, alternatively, the Company wished to transfer the ships to Avondale Industries, which was then constructing a number of T-AOs (eventually 16), where the ships could have been

completed at no additional cost to the Navy based upon the Navy's settlement with Pennship.

9. The Navy negotiated a final settlement with Pennship ensuring full compensation to the government for its excess reprocurement costs assuming completion of the vessels at Avondale.

10. Rather than transfer the ships to Avondale, however, the Navy towed them to Tampa Shipbuilding for completion, but subsequently terminated that contract also. Tampa had no experience in T-AO construction.

11. The primary issue is why the Navy decided to send the ships to Tampa Shipbuilding, where it spent over $100 million without completing the vessels, instead of to Avondale, who had agreed to complete the two vessels for $37.5 million, which amount was covered by the Pennship contract settlement.

12. From 1988 to 1994, various government agencies conducted approximately 17 investigations of this contract, in whole or part, with no action against Pennship.

13. Due in large part to the phase down of the 600-ship Navy, these uncompleted ships have been mothballed.

T-AO BID PROPOSAL

During its almost seventy-year history, the Pennship shipyard, under its various owners, designed and constructed over 650 vessels. It provided valuable service to this country, including the construction of many tanker vessels during World War II, and its later participation in Project Jennifer in the 1970s, when it constructed a high technology vessel for the Central Intelligence Agency to be used in a classified operation to lift a Russian missile submarine from the floor of the Pacific Ocean.

During the late 1970s, the shipyard was concentrating on the construction and repair of

commercial vessels and the repair and maintenance of U.S. Navy vessels. In an effort to improve the capability and competitiveness of the shipyard, its then owner, Sun Oil Company, began a major capital improvement program, investing over $100 million in facility modernization and improvements, including the construction of one of the world's largest floating drydocks, which is capable of lifting a battleship and other vessels weighing up to 70,000 tons.

By late 1981, Sun Oil decided to get out of the business and sell the shipyard. It sold the yard in February, 1982, to Edward Paden, the owner of two shipyards in Texas. Mr. Paden believed that this yard, with its improved facilities and long experience in large shipbuilding projects, was well suited to participate in the Navy fleet buildup that was then underway. Because of its history of tankers and other commercial vessel projects, it was believed that the shipyard could best participate through the construction of non-combatant, auxiliary vessels. With this strategy in mind, Pennship successfully bid on and completed the conversion of two commercial container vessels into military sealift ("TAKR") vessels for the Navy.

In 1982 Pennship also investigated the possibility of participating in the Navy program to construct a new class of 23 fleet oilers that were to be built to commercial specifications under a commercial form of contract, and manned by civilian personnel. This series of vessels, referred to as the "Henry J. Kaiser" class T-AOs, seemed to suit Pennship's capabilities perfectly, and Pennship submitted a bid jointly with one of Mr. Paden's Texas shipyards. The bid was unsuccessful, and the first series of four T-AOs was awarded to Avondale Industries in New

Orleans.

As this was a long series of vessels planned by the Navy, a number of shipyards interested in building auxiliary vessels for the Navy pressed for the award of future vessels to additional shipyards in order to keep the price competitive and to distribute the contracts to yards that needed work. As a result, Congress encouraged the Navy to establish a second source for T-AOs under its next solicitation, which was to be for a series of nine vessels.

Approximately two months before this second solicitation, Mr. Paden sold a controlling interest in the parent company of Pennship to the principals of The Weller Company in Mobile, Alabama, which included both Mr. Thomas Weller and Mr. Ronald Stevens. While Mr. Stevens has a considerable background in industrial engineering and construction, The Weller Company had been primarily involved in industrial and commercial real estate development. We conducted an extensive review of this company, its management, finances, and operations before proceeding with its purchase. We were most impressed with the facility itself, and we took great comfort from the management team that Mr. Paden had assembled. This group included a number of former Sun Shipbuilding management personnel that had been with the shipyard for many years, highly placed managers from Ingalls Shipbuilding, General Dynamics, and Newport News Shipbuilding, and included three current or former shipyard presidents. The then current president of Pennship was Rear Admiral Charles Payne, USN (Ret.), who, throughout his career, had supervised the construction and repair of vessels for the Navy, and who had served as the commanding officer of the Charleston Naval Shipyard and Comptroller of the Naval Sea

Systems Command, which is the command responsible for all naval vessel construction and procurement. Admiral Payne was assisted by Mr. John Serrie, who had worked in senior management positions in a number of U.S. shipyards, and had been President of Seatrain Shipbuilding Company in New York, as well as Mr. Paden, who, as mentioned earlier, had owned and operated a number of shipyards.

These gentlemen over their careers had been responsible for many projects equalling or exceeding the scope of the T-AO contract, and they were principal members of the team that developed the Company's T-AO bid proposal. Combined with the experience of the other senior managers involved in the bid preparation process, this team had well over 100 years of experience in this type of ship construction and estimating. As the new controlling owners of Pennship, we reviewed and agreed with the Company's strategy to pursue U.S. Navy business generally, and, specifically, to bid on the pending series of T-AOs. We sat in on many of the T-AO proposal discussions and satisfied ourselves that this was an experienced, confident, and professional group of people who approached the bid estimate in a detailed and responsible manner.

The Company's T-AO bid proposal was completed and submitted on October 18, 1984. Although in hindsight everyone, including the Navy, agrees that the price bid by Pennship left little or no margin for error or other unforeseen events, the Navy found Pennship and all other bidders to be within the "competitive range" for these vessels, meaning that no yard was either too high or too low to warrant elimination from the competition.

During subsequent discussions, the Navy gave Pennship no indication that its bid was unrealistically low, which was consistent with the Navy's policy during the 1980s to encourage aggressive bidding by U.S. shipyards. During this period, shipyards were operating in an environment where there was little or no commercial work available, due largely to the elimination of construction subsidies in 1981. The Navy was essentially the only customer, and it was contracting on a lowest price only basis. This policy drove shipyards to marginal price levels to survive. Indeed, following this particular T-AO solicitation, General Dynamics Corporation announced the closing of its 100 year-old shipyard in Quincy, Massachusetts, soon after learning that its bid was unsuccessful.

T-AO CONTRACT AWARD

In January 1984, following customary procedures, the Navy informed Pennship of its wish to conduct a pre-award survey of the shipyard, indicating that Pennship was likely the low bidder. This survey included an extensive review of the shipyard's facilities and technical capabilities, as well as an analysis of its corporate and financial condition.

Because of the recent investment and upgrade of its facilities, as well as the Company's performance on the TAKR conversion program, the shipyard easily satisfied the Navy as to its technical ability. With respect to its financial and corporate matters, in addition to its own review, the Navy retained the independent accounting firm of Peat Marwick to conduct a review of the Company. This effort involved an analysis of the Company's financial condition, as well

as many aspects of the Company's bid proposal. Peat Marwick representatives visited the shipyard to meet with the managers who participated in the development of the bid in order to discuss their methodology and assumptions. In the end, Peat Marwick recommended that the Company be found financially responsible, and according to the Contracting Officer, Harold Hanson, found no reason for the Navy not to award a T-AO contract to Pennship.

At one point during the pre-award survey, the Navy inquired as to how the Company might deal with a shortage of $15 - 20 million during the performance of the contract. Our response was that if additional capital were not available from other sources, the Company could sell off assets to provide the funds necessary to cover such a shortfall. In order to further assure the Navy that the Company was willing to do this, we went so far as to offer a second mortgage on shipyard property to cover such a situation. Following the Peat Marwick recommendation, such an arrangement was not necessary to grant a contract to the Company. Nevertheless, the Navy accepted a subordinated security interest in Company property up to a maximum of $20 million to secure any amounts the Company might eventually owe the Navy as a result of any failure to complete the contract. This did not in any way limit the liability of the Company to $20 million, it only provided the Navy a security interest in Company property for this amount.

Having been satisfied as to the Company's technical and financial ability, the Navy awarded a contract to Pennship on May 6, 1985, for two T-AOs (T-AO 191 and T-AO 192) with options for additional vessels in 1986 and 1987. The contract price was anything but simple. Simply stated, however, the "target price" for the two vessels was $222,476,849, plus

additional payments for changes and escalation to cover the cost of inflation during the contract period. (The target price was calculated in April, 1984 dollars, with the Navy assuming the risk of inflation and paying escalation separately as determined by a formula set forth in the contract.) In addition, the contract provided that the Navy would pay 50% of all costs over a pre-agreed "target cost," which payments could not exceed an aggregate contract price of $262,900,000, plus changes and escalation for the two vessels. This latter amount is referred to as the "ceiling price," which is the Navy's maximum cost obligation under the contract. This price structure was required by the Navy from all bidders, and is one that has been used often by the Navy in ship construction contracts.

T-AO CONTRACT PERFORMANCE

The Company began work on the contract, experiencing the typical and not unexpected shipyard difficulties in the construction of the first of a new series of vessels. In addition, however, the Company began experiencing several unanticipated problems. First, the Company soon began to experience cash shortages due to its aggressive bid. This was exacerbated in time by the absence of other Navy work that had been assumed in the bid proposal for purposes of estimating the overhead expenses to be carried by the T-AO contract.

Second, we experienced delays and rework resulting from the failure of the Navy to provide engineering that it had purchased for these vessels from the lead shipyard.

Third, and most frustrating, the Navy assigned the supervision of this contract to a team

of supervisors and inspectors that were not experienced in new construction projects. This team consisted mostly of individuals whose experience was limited to repair work.

Fourth, instead of the five inspectors originally provided for in the contract, which would have been more typical for what was to be a "commercial" construction program, the Navy quickly built up to a team of over thirty inspectors, which adversely affected the smooth progress of the contract.

The situation with the Navy's inspection team became much more critical when its unfamiliarity with new construction, especially a "commercial" new construction program, resulted in continuing delays in the processing of the progress billing invoices submitted on a bi-weekly basis. As one can imagine, enormous sums of money were being spent very quickly in procuring material and labor to construct vessels of this size. As progress payments for completed work were delayed, the slow strangulation of the Company began. As the Company's vendors and suppliers became aware of the problem, they increasingly became unwilling to provide desperately needed equipment and material for the vessel without payment in advance or upon delivery. When this disrupts the orderly flow of material to the workshops and the vessel, productivity decreases as the original production plan for the vessel is disrupted. Man-hours begin to increase. Man-hours that were not included in the bid proposal.

Despite these problems, the skilled and dedicated work force at Pennship began producing two high-quality tankers for the Navy. Being built to commercial standards and requirements, the vessels' construction was constantly inspected and supervised by

representatives of the American Bureau of Shipping (ABS), which is an independent industry body that regulates and certifies the design and construction of commercial sea-going vessels, and is delegated by the Coast Guard to conduct certain inspections and issue necessary certificates for such vessels. The Company experienced no difficulties in obtaining satisfactory approvals from ABS for the work being performed on these vessels. Indeed, the Navy was satisfied enough to award the Company two additional vessels (T-AO 194 and T-AO 196) in 1986 and 1987 for an additional target price of $192,009,779, plus changes and escalation, increasing the contract ceiling price for all four vessels to approximately $489,000,000, plus changes and escalation.

However, because of the increasingly serious cash flow problems being experienced by the shipyard, as well as complaints being heard from the local supervisors and inspectors, the Navy began expressing doubts about the Company's ability to complete the vessels and fulfill the T-AO contract. In early 1988, in an effort to determine the facts for ourselves, as well as to convince the Navy that Pennship was fully capable of completing the contract provided an adequate cash flow and proper Navy contract administration and supervision was established, we decided to retain a group of outside experts to investigate the status of the contract, the quality of the vessels, and to advise us as to what could be done to improve the situation. Accordingly, we located and contracted with the group that had been retained by the Navy to perform the same service for the government in its review of the guided missile destroyer program (DDG 51). If this group was competent enough to advise the Navy on these matters, not only would

they be competent enough for us, but their report might very well dispel any notion of the Navy that these vessels could not be built at Pennship.

The team performing this task was headed by Rear Admiral William Wyatt, USN (Ret.), who had a distinguished career supervising the construction and repair of vessels for the Navy; and it included other highly regarded and experienced individuals such as Vice Admiral Russ Bryan, USN (Ret.), who had served as the Commanding Officer of the Naval Sea Systems Command. According to his final report, Admiral Wyatt's team analyzed many aspects of the shipyard's operations, including production, facilities, management, quality, work force schedules, procedures, material, contract, and financial matters. Admiral Wyatt reported that there was no problem with the quality of the completed work on the vessels, and that the shipyard was fully capable of constructing the T-AOs. Admiral Wyatt also recognized that there were the typical problems encountered with the beginning of production of the first vessel, but he expressed satisfaction that these problems were being overcome, particularly with the second vessel in the series. His remaining concern was that the production process would continue to be adversely affected by the lack of material and supplies needed for work on the vessels, which, of course, were being delayed because of the shipyard's cash flow difficulties. We were encouraged by Admiral Wyatt's report, particularly with his observations on the improvements being experienced on the second vessel. A copy of Admiral Wyatt's conclusions was forwarded to the Navy.

At this point it might be helpful to reemphasize one aspect of this program that was

central to Pennship's bid. The T-AO contract was based upon commercial rather than military terms and standards, on the theory that commercial construction was less expensive and there was little need for a military-type specification or contract administration for a non-combatant oil tanker.

Commercial ship construction is approached on a completely different basis. There is a strong recognition that the building of a huge ocean-going vessel is a complex undertaking that requires flexibility and cooperation from both the builder and the owner. The owner is investing huge sums of his own money in progress payments during construction, and he recognizes that it is imperative that his vessel be completed as efficiently and quickly as possible in order to put it to work to provide a return on his investment. The builder, on the other hand, realizes that the sooner he completes the vessel, the less costly the contract will be to him in terms of man-hours and overhead. As a result, from the beginning of construction, both parties are working together with a common objective born of economic self-interest. For example, the owner will not over-supervise construction, relying instead on the inspection and certification of the vessel by the American Bureau of Shipping, and a small number of his own representatives experienced in vessel construction. More importantly, he will maintain a willingness to assist the builder when unforeseen problems develop, recognizing that both parties have the same objective in mind.

Unfortunately, this was not the approach taken by the Navy inspection team at Pennship. It treated the vessels much like combatants and subjected their construction to levels of inspection not contemplated in the bid proposal, which only duplicated the efforts of the

American Bureau of Shipping already required by the contract, disrupted production, and increased the man-hours required of Pennship. This situation was aggravated by the inexperience of the team in new construction projects. Rather than an atmosphere of cooperation, Pennship was faced with an adversarial "owner" acting without apparent concern for the efficient and timely delivery of the vessels. As any shipbuilder will agree, this attitude will assure the existence of delays and overruns.

T-AO CONTRACT MODIFICATION

Although the quality of work being performed on the vessels was going well, the Company's financial difficulties continued to worsen. As knowledge of this spread to the industry, the Company was approached by Avondale Industries, which by now was well into its first contract for four vessels and since had been awarded a contract for at least three more T-AOs. Eventually, Avondale would construct sixteen T-AOs. Being so far along in the production of such a long series of vessels, Avondale was in a position to confidently estimate the cost of constructing additional T-AOs at very attractive prices. It is a common experience in the industry that with each additional vessel, one becomes more efficient in production and more accurate in estimating.

With these advantages, Avondale proposed to assume the contractual obligation to construct the two option T-AOs awarded to the Company (T-AO 194 and T-AO 196). The Navy was quite interested in this proposal, and as a result of discussions between Pennship,

Avondale, and the Navy, the Pennship contract was modified to transfer the contract for these two vessels to Avondale.

The Navy cooperated and assisted in these discussions between Pennship and Avondale, but throughout, it imposed one condition: no additional money would be made available by the Navy for this contract. Any agreement would have to be within the cost limits of the original contract. This is a most important point, because it has been reported erroneously that with this modification the Navy bailed this contract out with additional funds. That is simply not the case. The Navy has consistently and correctly maintained that the amendment to the Pennship contract transferring two vessels to Avondale did not increase the Navy's financial obligation. The overall contract was converted from the earlier described fixed-price incentive structure, to a firm fixed-price contract that now included amounts for escalation and contract changes that were previously being priced and paid outside of and in addition to the original $489,000,000 ceiling price for the four vessels. The new all-inclusive firm fixed-price for the four vessels was set at approximately $558,000,000. Pennship negotiated a price with Avondale for the construction of T-AO 194 and T-AO 196, and the remaining funds, $331,400,000, were left to Pennship for T-AO 191 and T-AO 192. At this time, according to the Navy-approved bi-weekly progress reports, T-AO 191 and T-AO 192 were 86% and 64% complete, respectively.

T-AO CONTRACT TERMINATION

Although it relieved the Company of the obligation to construct the two option

T-AOs, this contract modification did not correct the financial difficulties associated with the first two vessels. This was clearly understood by Pennship and the Navy, but it was agreed to take it "one step at a time." The Navy was fully aware that there were still problems to be dealt with. In fact, the financial assumptions upon which the Navy was proceeding at the point of this contract modification included the assumption that Pennship would receive a new contract for three additional T-AOs. While the Company was concerned with this approach because there was no guarantee of such an award, the Navy insisted that this assumption be factored into the Company's financial projections. When this contract did not materialize, and no other contract of a similar magnitude was forthcoming, it was clear to all parties that something would have to be done. Either additional work had to be found for the shipyard, or additional funds would have to be added to the contract.

As 1988 came to a close, it was evident that neither was going to happen. In fact, rather than obtain new work, the Navy was finding ways to reduce other Navy repair work in the shipyard. In one case, a Pennship contract was terminated by the Navy due to a lack of Navy funds, with the Navy curiously finding the funds 30 days later and rebidding the work with an eventual award to another yard. More significant than this loss of work was the attitude evidenced by this behavior. This attitude was confirmed at the highest level on December 13, 1988, when the Secretary of the Navy, William Ball, wrote to Congress that the closure of three shipyards, Pennship, Bethlehem Steel of Sparrows Point, Maryland, and Tampa Shipyards of Tampa, Florida, would have only a minimal impact on the industrial mobilization scenario for

new vessel construction, and the payment of any premiums for contracts to keep any of these yards open was not justified. In other words, the Navy no longer was interested in the survival of Pennship, or Bethlehem Steel or Tampa for that matter.

Thus, by the end of 1988, it was clear that the Navy was not going to help. The Company was not going to receive new Navy work to help it out of its financial crisis, and no new funds would be made available under the contract. This was a most critical point in this contract history, and it is most unfortunate for both Pennship and the Navy that this was their decision. With a moderate amount of financial help at this time, an amount far less than the amount the Navy would ultimately spend to continue the work elsewhere, Pennship would have completed and delivered the vessels.

It was about this time that the Navy directed Pennship to begin considering "alternatives" for the completion of the vessels. Under the circumstances, despite the advanced state of completion of the first vessel, the only possibility open to the Company was to subcontract the completion of the vessels to another shipyard in order to make the most of the funds remaining in the contract. If additional funds would be necessary, they could come from the liquidation of shipyard assets.

In January, 1989, the Company sought bids from a number of shipyards that earlier had expressed interest in this program. The lowest bid was received from Avondale Industries, which was not surprising as they were the lead T-AO shipyard, and they had already assumed responsibility for the construction of T-AOs 194 and 196.

In February of 1989, the Navy issued a stop work order on the Pennship contract. This removed any chance of Pennship completing the vessels under the contract, because stopping work in this way so completely disrupts the procurement and production process that it is very difficult to resume without incurring significant additional costs. Therefore, the Company intensified its efforts to find a subcontractor for the vessels. After further discussions, Avondale remained the lowest bidder and the obvious choice to complete the vessels. During this process, three yards competed for this subcontract, Avondale, Tampa Shipyards, and Bethlehem Steel. (It was not known to us at the time that the last two already had been written off by Navy Secretary Ball.) All three shipyards sent teams to Pennship to inspect the vessels and make any other investigations that they deemed necessary in order to prepare a proposal. At this point, Avondale's bid to complete the two vessels was $38,500,000. While there was more than this amount remaining in the Pennship contract to cover these costs, there would certainly be additional costs in transferring the vessels and materials to Avondale and settling any other amounts that may be owed to the Navy. Accordingly, Pennship began preparing draft agreements for the transfer to Avondale.

In the middle of this process, the Navy directed Pennship to resume work on the vessels for the limited purpose of preparing them for transfer to another shipyard, and it took control of the process of finding a new shipyard to finish the vessels. This was inexplicable, as the Company had already reached a satisfactory arrangement with Avondale that would have finished the vessels for the Navy, and negotiations were not yet complete. Not only were the prices of

the other two bidders considerably higher, but neither shipyard had any experience in building these vessels, which would make their completion all the more costly and difficult. Nonetheless, the Company turned its attention to the work necessary to transfer the vessels, and it began discussions with the Navy concerning the termination of its contract and the settlement of any outstanding claims of the two parties.

Eventually, in August of 1989, the Navy and the Company entered into an amendment to the T-AO contract by which the contract was terminated; the cost for the Navy completing the vessels in another shipyard that exceeded the funds remaining in the contract was determined; and claims of both parties, including a number of Pennship claims against the Navy under five unrelated ship repair and maintenance contracts, were settled. Of course, in order to determine the cost to the Navy of completing the T-AOs elsewhere, one would have to know where the vessels would be completed and how much it would cost. The Navy had not yet made the final selection of the reprocurement shipyard, but the Navy agreed in the settlement negotiations that the obvious choice was Avondale Shipyards, and that Avondale's price proposal, which by then had been reduced to $37,500,000, would be used to calculate the Navy's reprocurement costs. At this time, between $30,000,000 and $40,000,000 remained in the Pennship contract, and, according to the Navy-approved bi-weekly progress reports, T-AO 191 and T-AO 192 were 91% and 74% complete, respectively.

Including work for final preparations to transfer the vessels, and the settlement of other amounts the Navy claimed were owed by the Company, the extra cost that would be incurred by

the Navy to complete these vessels at Avondale was calculated to be slightly over $26 million. Based upon the arrangements that were being made, and the fact that Avondale was fully prepared to assume responsibility for these vessels, there was no reason to believe at this point that the vessels would not be completed and the Navy made whole.

As part of this same modification terminating the contract, the Company and the Navy discussed the settlement of the $26 million excess reprocurement cost to the Navy. Pennship reiterated the numerous claims it had against the Navy for what we believe was the Navy's significant contribution to the contract's failure, as well as open payment issues remaining between the Company and the Navy under the other five repair and maintenance contracts. As a result of these discussions, the Navy accepted title to the Company's floating drydock for an agreed value of $19,000,000, which amount was equal to its appraised fair market value. In return, the Company released certain claims against the five repair and maintenance contracts, agreed not to appeal the Navy's termination of the T-AO contract, and released all claims against the Navy under the T-AO contract, all in full settlement of the Company's liability for the excess T-AO reprocurement costs. This settlement was based upon the Navy giving Pennship a credit of $2,000,000, mostly for the Company's claims under one of the five repair and maintenance contracts, bringing the total payments to the Navy under this modification to $21,000,000.

In addition, the Navy agreed that the $5,093,466 of excess reprocurement costs remaining unrecovered would be a contingent liability only, and would be paid by the shipyard from excess cash flow over the next 13 months after contract termination. The Company and the Navy

recognized that excess cash flow would likely be realized only in the event that a shipyard liquidation over the next 13 months after contract termination yielded a windfall profit -- something both parties understood to be highly unlikely. That this remaining contingent amount was to be paid only under such circumstances was the Navy's final recognition and settlement of Pennship's claims that were released under this agreement. Indeed, although the Company was not in a strong bargaining position, we would have resisted any settlement that did not give some recognition for these claims.

While the Company subsequently liquidated some shipyard assets, it did not trigger a payment under this contingency payment clause, and a final release was executed by both parties on January 13, 1992. We should note that under the contingency payment terms, the Company was required to include, for payment calculation purposes, any unliquidated assets and liabilities at the end of the 13-month liquidation period at appraised fair market values. Even so, no payment was required by the agreement formula.

T-AO 191 AND T-AO 192 TRANSFERS

Once the contract between the Navy and Pennship was settled, the Navy turned its attention to its final selection of a shipyard to complete the vessels. Throughout this process the Company continued to assume that the vessels would go to Avondale, as this solution provided a virtually certain resolution of the contract. There was no question in anyone's mind that Avondale could take over these vessels at their then state of progress and complete the remaining

9% of T-AO 191 and 26% of T-AO 192. For reasons unknown to Pennship, however, it took several months for the Navy to select a shipyard. For reasons even less understood by the Company, it was finally announced that the vessels were to go to Tampa Shipyards at a price higher than that quoted by Avondale for "industrial mobilization base" purposes. This was a most puzzling decision because, until then, the Navy had consistently and firmly maintained that "industrial mobilization base" funds would not be made available for this contract, and because there was some question as to whether Tampa would be able to complete these vessels for anything even remotely approaching the price quoted by Avondale shipyard.

It is risky enough removing vessels from a shipyard for completion elsewhere. In fact, Admiral Wyatt, after concluding his review of the Pennship contract, advised the Navy on two occasions that the best solution for the Navy would be to complete the vessels at Pennship. He pointed out that the Navy had never had a good experience in removing vessels from one shipyard for completion at another. He encouraged the Navy to find a solution, in its own interest, at Pennship.

While the Navy decided not to follow Admiral Wyatt's advice, at least we could have understood the vessels going to Avondale Shipyards. Having contracts to build sixteen of these vessels meant that no one knew these vessels better. No yard could inspect these vessels and determine exactly what had to be done with the confidence and certainty of Avondale. For the Navy, if it did not want to complete the vessels at Pennship, this, at least, was as good a solution as one could find. The Navy would have been fully confident that the vessels would be

delivered to the fleet within a reasonable period of time.

Even today, we cannot understand why those vessels did not go to Avondale. We do believe, however, that had they gone to Avondale, the vessels would be serving the fleet today, and the Navy would not have added any funding to the original contract awarded to Pennship. Indeed, the Navy was fully aware of this. On two occasions, both during and about one year after the transfer to Tampa, the Navy's Contracting Officer voiced the opinion that the vessels would never be completed at Tampa, and that before it was over the Navy would be towing the two vessels from Tampa to Avondale for completion.

CONCLUSION

Pennship's experience with the T-AO contract was not unique to the shipbuilding industry in the 1980s. Because of the highly competitive environment and the Navy's contracting policies, cost overruns were common. The Government Accounting Office issued a number of reports on this problem, estimating cost overruns over target costs in the billions, and overruns over ceiling prices in the hundreds of millions. Most of these overruns were in contracts for highly prized combatants, particularly attack submarines, cruisers, and destroyers. It found that in most of these cases overruns were covered by shifting funds within the programs and, with Congressional approval, between programs. What was unique in the case of the Pennship T-AO contract was the unwillingness of the Navy to help with any similar reprogramming or with additional repair work that would have helped the yard's cash problems. Obviously, oil tankers

simply were not as important as submarines. But just as obvious from Secretary Ball's letter, Pennship was not as important as those shipyards constructing the favored combatants.

In the end, Pennship failed to complete its T-AOs. But we wish to emphasize again that we satisfied all remaining obligations to the Navy. The true debacle that has occurred here did not begin until the vessels were towed out of Pennship. When the option of completing the vessels at Pennship was closed out, the Company entered into a settlement with the Navy of all mutual claims and liabilities, and it honored completely the terms of that settlement. Since we did not have the economic resources to enter into a long drawn-out legal battle with the Navy over the T-AO termination and other claims, we reached the best settlement that we could, and we made full payment under the terms of that settlement. As a result, the Navy was in as good a position as ever it could be in an unfortunate case such as this.

We agree with Admiral Wyatt that the Navy would have been better off leaving the vessels at Pennship, or at least transferring the vessels to Avondale for completion. For whatever reasons or perceived benefit the Navy had in mind when it ultimately took those vessels to Tampa, this is not a responsibility of Pennship. We are not proud of the fact that we did not complete these vessels, but we are proud of the fact that in that situation we settled all of the Company's obligations to the Navy and helped the Navy reach a position where it could achieve completion of the contract and delivery of the vessels to the fleet.

What we have just related is an accurate and complete review of the facts in this matter. When this much money is spent on two vessels that are delivered unfinished to the Navy, it is

understandable that there would be many questions and a desire to find someone to blame. There are other stories that have circulated in connection with this contract. We have heard them all, and we have read of them in the media. These stories involve allegations of technical incompetence and misrepresentations to the Navy. They have included irresponsible accusations of "ghost employees" being charged to the Navy. In response, all we can tell you is that these accusations are false, and that this matter, since 1988 and continuing until very recently, has been subjected to investigations by various government agencies. Every one of these investigations was concluded without any action against the Company, and all financial claims of the Navy have been settled.

We are pleased that numerous investigations have found no basis for these accusations, and we are gratified to have this opportunity to present to the Committee our side of the story and to tell you here today that this is the true story, and that at all times we have acted honorably in our dealings with our government.

STATEMENT

William R. Boyles, Jr.
Vice President - Finance
Tampa Shipyards, Incorporated

Good morning, Mr. Chairman and Members of the Subcommittee. I am William R. Boyles, Jr. I am Vice President in charge of finance for Tampa Shipyards, Inc.

TSI's Government Shipbuilding History

Contrary to some of the testimony you have heard, TSI was a very good shipbuilding company. In the mid 1980's TSI successfully built five (5) T5 Tankers for charter to the Military Sealift Command. The ships were completed early and within the contract price with no cost overruns. In the late 1980's TSI completed the conversion of two (2) crane ships for MARAD. Although TSI experienced cost overruns in excess of $13 million, the workmanship was considered to be excellent. In the early 1990's TSI began the design and construction of the TAGOS surveillance ship. During the course of that work, TSI earned every performance bonus available under the contract. In fact, the NAVSEA Program Manager described TSI's performance on the TAGOS Ship as a "model to be followed by other ship builders". To even suggest that TSI was not a good shipbuilder is totally false and a disservice to the thousands of hard working men and women employed by TSI.

The Award of the TAO Contract

TSI was awarded the contract for the completion of TAO 191 and 192 in 1989. TSI's bid was approximately $6 million higher than the Avondale bid. On November 16, 1989 the Navy issued a formal "Justification and Approval" for the award of the contract to TSI. I am surprised that the Inspector General testified that he was unable to locate that report. Our attorney secured a copy of that report in response to his Motion to

Compel Production of documents in our suit against the Navy. I have a copy of that report in my possession and would be pleased to share it with this Committee if requested. In that official document, the Navy made the following statements:

1. "The strategy for the reprocurement of the TAO 191/192 is based on the need to maintain the national industrial mobilization base..."

2. "If NASSCO were to cease being a competitor in two years, Avondale would effectively be left as the sole remaining source for large auxiliary ships. Further, the condition of the 3 remaining shipyards has also markedly deteriorated. Therefore, the industrial base for large auxiliary ship construction is not secure."

3. "...the award of this effort to a financially unstable company like Tampa could serve as a company "bridge" to new work under the proposed Fast Sealift Program."

4. "In view of the circumstances discussed above, it will be in the interest of the National Defense to maintain another shipyard as a viable competitor..."

5. "...an award of completion of the TAO 191 and TAO 192 to Tampa is considered the most cost effective means (less than a 5% premium with respect to the total program contract cost) to maintain a viable industrial mobilization base for large auxiliary ship construction in the near term of two years".

Interestingly enough, in this November, 1989 report the Navy specifically addresses the questions raised by this Committee on Tuesday with regard to the 1988 determination by the Navy that the "closure" of Bethlehem, PSC and Tampa would not affect the Shipbuilding Production Base. In 1989 the Navy concluded that NASSCO was "not nearly as solid a competitor as it was at the time the 1988 analysis was performed." In this 1989 document, the Navy went on to conclude that "if NASSCO were to cease being a competitor in two (2) years, Avondale would effectively be left as the sole remaining source for large auxiliary ships." The Navy further reported that "the condition of the three (3) remaining

shipyards has also markedly deteriorated." Based upon this 1989 analysis taking into consideration the change in condition of the various shipyards, the Navy specifically concluded that "the industrial base for large auxiliary ship construction is not secure."

Avondale filed a protest alleging that the award was improper in that it was not made on the basis of competitive quotation and further alleged that the award was improperly motivated by pressure from the entire Florida Congressional Delegation. On December 29, 1989 the Navy formally responded to Avondale's protest. That response included the following remarks:

> "Avondale's protest is entirely without merit and should be denied".
>
> "The Navy properly concluded that it was in the interest of national defense to maintain Tampa as part of the shipbuilding industrial mobilization base. The decision to award the reprocurement contract to Tampa was made on the basis of appropriate factors for mobilization base decisions."
>
> "Lastly, the Navy's decision was not improperly influenced by Congressional pressure."
>
> "Avondale is requesting that GAO issue a decision, the effect of which would be to put Tampa, a potential competitor of Avondale, out of business, despite the Navy's effort to retain Tampa as part of the nation's shipbuilding industrial mobilization base."
>
> "Avondale, in this same TAO Program, was the beneficiary of an award when Avondale was not the low offeror. Simply put, Avondale's position is untenable."

The Navy's comments with regard to Avondale being the beneficiary of a prior award when it was not the low offeror were in fact a predictor of things to come. Avondale has continued to enjoy a preferred status insofar as the Navy is concerned. A review of the

financial statements of both Avondale and TSI in 1992 will establish that both companies were financially unstable. At that time both Avondale and TSI had filed requests with the Navy for 85-804 relief in the amount of $25 million. TSI's request was denied. Avondale's request was approved. At that same time Avondale's financial reports indicated that bankruptcy was a probability without additional help from the Navy. During that period Avondale had pending in excess of $300 million in requests for equitable adjustments based upon cost overruns. It's significant that Avondale was building TAO from scratch whereas TSI was attempting to correct mistakes created by the previous builder of TAO 191 and 192. All ship builders agree that it is much more difficult and expensive to complete a contract commenced by another yard, particularly after a default, than it is to do the entire job in one yard. In spite of this distinct advantage, Avondale filed requests for equitable adjustments in excess of $300 million and the Navy ultimately settled those requests by paying Avondale $143 million. The bottom line is that the Navy saved Avondale from bankruptcy and at the same time caused the bankruptcy of TSI.

I want to make it clear that we are not criticizing Avondale. However, the term "bail-out" has been used in these proceedings. It's clear that if there has been any "bail-out" Avondale received a far greater share than did TSI.

Problems with the TAO Contract

In spite of TSI's excellent performance on the T5 Tanker Contract and the TAGOS Contract, there were severe problems with regard to the TAO Contract. Simply stated, the TAO materials received from Penn Ship were not what they were represented to be. TSI's attempts to correct these problems within the contract price created a substantial cash

drain. The Navy was unreceptive to TSI's requests for help even though the equipment previously inspected by the Navy was inoperable. Just as Avondale found itself in an untenable position, TSI was in a worse position in that it was having to correct problems created by a previous builder. Even though the contracting officer had suggested that TSI file an 85-804 request for extraordinary relief, this request was ultimately turned down by the Navy.

In October, 1992 Congress passed the Department of Defense Appropriations Act for fiscal year 1993 which included some relief for TSI. Specifically, the contract price for the TAO was increased by $45 million. TSI did not receive the $45 million. The Act simply increased the total price of the contract by $45 million. The Act further directed the Secretary of the Navy to pay TSI the difference between the total allowable costs incurred and the total payments to date. To put it bluntly, Congress directed the Navy to pay TSI what it was owed under the contract at that time. That difference amounted to $12.1 million and that payment was in fact made to TSI. It must be stressed that the $12.1 million represented payment of incurred allowable costs as determined by a government audit. That payment represented no profit to TSI. To the contrary, the $12.1 million was used to immediately pay vendors and costs previously incurred.

I have been informed that the Inspector General testified on Tuesday that the $12.1 million payment was used to retire investor guarantees. Unfortunately, the Inspector General obviously did not have an opportunity to review his formal report before testifying. I have a copy of that report in my possession and would be pleased to provide it to the Committee upon request.

The Inspector General's Official Report concerning the Appropriations Act noted that the Act also provided for a payment to TSI of $13.3 million in settlement of the cost overrun suit filed by TSI in the Federal District Court in Tampa. These cost overruns were not related in any way to the TAOs. To the contrary, they were incurred as a result of TSI's conversion of two container ships to Auxiliary and Crane Ships pursuant to a MARAD Contract.

In summary, TSI received $12.1 million on the TAO Contract. These funds were immediately paid to vendors and suppliers on the TAO Contract. TSI also received $13.3 million in settlement of its claim against MARAD. These funds should have in fact been paid to TSI in February and May of 1989 when the Crane Ships were delivered. The failure to pay these additional requested costs in 1989 caused TSI to have to seek additional guarantees from Mr. Steinbrenner. As usual, Mr. Steinbrenner responded. AMSHIP's Board of Directors elected to use $8 million of the MARAD settlement to secure two letters of credit posted by TSI in connection with the TAO and TAGOS Contracts. Mr. Steinbrenner was relieved of his personal guarantee on those two letters of credit. As a practical matter, Mr. Steinbrenner would not have had to guarantee the letters of credit had MARAD recognized the cost overruns in a timely manner. In addition, $7 million of the $8 million cash collateralized LOC's was ultimately used to pay Navy vendors on the TAO and TAGOS Contracts in April, 1993. Therefore, all of the $12.1 million payment on the TAO Contract and practically all of the MARAD settlement ultimately went to the payment of TAO and TAGOS vendors.

7

Bad Faith Acts and Breach of Contract
By the Navy

Following the passage of the Appropriations Bill in October, 1992, the Navy refused to cooperate in any way with TSI and in fact took deliberate steps to try to cause TSI to fail. From October, 1992 until early February, 1993 the Navy paid TSI only its incurred costs. It refused to pay any profit earned even though the payment of such profit would have significantly helped TSI's financial position. The Navy in fact breached the contract by refusing to make any payments whatsoever to TSI between early February, 1993 and April 28, 1993. In late April, 1993 the Navy created an escrow account from which vendors would be paid. The effect of this escrow account was to trap TSI's own funds previously paid to vendors during the period of time that the Navy was refusing to make any payments to TSI. The Navy refused to release such trapped funds even though they had agreed to do so prior to the creation of the escrow account. Prior to July 16, 1993 the Navy conducted a statistical study which in effect increased the estimated cost to complete the TAO's by approximately $130 million. This statistical study ignored the fact that TSI had made more progress toward completion during the preceding four months than it had ever made in the past. In addition, the Appropriations Bill directed TSI to do a complete survey of the ships and make an exact determination as to the remaining work to be done. TSI in fact performed that detailed survey and concluded that TSI would complete the ships within the contract price and in fact earn a profit of approximately $10 million. In an attempt to justify its statistical survey, the Navy requested that the Defense Logistics Agency review the matter. James Bauer, the Defense Logistics Agency representative, testified that there was a reasonable basis for the Navy's statistical projections. However,

Mr. Bauer also testified that TSI was in a better position than anyone to know the exact amount of work remaining to be done, that he had no reason to question any of TSI's projections as to the work to be done and the cost to complete, and that the Navy did not ask him to evaluate TSI's projections and that therefore DLA did not do so.

A Cure Notice was issued by the Navy on July 16, 1993 followed by a Default Termination on August 25, 1993. Based upon records produced by the Navy in discovery during the course of TSI's suit against the Navy, it appears that as early as July 6, 1993, ten (10) days prior to the issuance of the Cure Notice, the Navy knew that there was no longer any need for the Tampa TAOs. Indeed, it was TSI's position in the lawsuit that the Navy used the pretext of a Default in order to avoid the payment of termination for convenience damages to TSI for ships that the Navy no longer needed.

The Petition to Reinstate

Subsequent to the issuance of the Default, TSI filed a Petition to Reinstate the TAO Contract. That Petition included the following unrestricted and unequivocal offer or guarantee of George Steinbrenner:

1. An immediate infusion of cash or credit from George M. Steinbrenner in the amount of $11 million for the unrestricted use of TSI. The Navy had previously projected that $6 million to $10 million would be necessary to complete the job.

2. A personal guarantee from Mr. Steinbrenner that TAO 191 and 192 would be completed for the price provided by the contract. In the event that the cost of completion exceeded the contract price, Mr. Steinbrenner would have been personally responsible for any excess costs. Mr. Steinbrenner and TSI waived any claim for cost overruns and guaranteed to deliver the ships to the Navy for the Navy's price.

3. Mr. Steinbrenner guaranteed to maintain a minimum $1 million cash balance in the TSI bank account until the ships were completed.

When the NAVSEA representatives were questioned on deposition in the TSI -vs- The Navy Lawsuit, they generally testified that they either did not understand the reinstatement offer and guarantee made by Mr. Steinbrenner or that they didn't believe the offer. In either event, they admitted that they never presented Mr. Steinbrenner with the opportunity to sign a contract containing all of the aforementioned guarantees. In addition, it is now clear that the Secretary of the Navy was not fully and adequately briefed on the Steinbrenner guarantee. The Secretary admitted on deposition that he was not told of Mr. Steinbrenner's guarantee to maintain a $1 million cash balance in TSI's account for the remainder of the contract. The Secretary admitted on deposition that this was a very significant commitment by Mr. Steinbrenner and that obviously the information should have been provided to him by the Navy.

In truth and in fact the Navy turned down George Steinbrenner's guarantee for the simple reason that the Navy had made the decision that it no longer needed TAO 191 and 192. In truth and in fact, TAO 191 and 192 sit rusting and unfinished in the James River in Virginia for the simple reason that the Navy did not want to finish them.

The Bankruptcy and the Lawsuit

On November 4, 1993 TSI filed a Petition for Reorganization in the Bankruptcy Court in Tampa, Florida. TSI also filed Motions to Assume the TAO and TAGOS Contracts. The Bankruptcy Court ruled that the TAO Contract could not be assumed because it was defaulted prior to the bankruptcy. The Court further ruled that the TAGOS Contract was assumable in that it had not been defaulted. The ruling on the TAO Contract was appealed to the United States District Court in Tampa. TSI subsequently

filed suit against the Navy in the Bankruptcy Court in Tampa seeking termination for convenience damages. TSI filed a similar suit against the Navy in the Federal Court of Claims in Washington, D.C. In connection with its lawsuit TSI was permitted to take depositions of the local Navy supervisory personnel, representatives from the contracting and program office, captains, admirals and even the Secretary of the Navy. In addition, the Navy was required to produce thousands of pages of documents including briefing papers to the Secretary of the Navy as well as documents confirming that the Navy had no need for TAO 191 and 192. TSI's trial counsel advised the company that the suit was meritorious and that TSI's chances of prevailing were in the 75% range.

The lawsuit was ultimately settled for the total sum of $18 million. In addition, TSI agreed to dismiss all of the lawsuits and further agreed to assign TAGOS to Halter Marine. During the course of the settlement negotiations the Navy requested and TSI agreed to a Defense Contracting Audit Agency Audit. The Audit was in fact performed and confirmed that TSI's incurred, allowable, and unpaid costs amounted to approximately $26 million. The Audit confirmed that these were in fact costs that were allowable and payable under the contracts. Again, this number was confirmed by DCAA. In addition to the $26 million in unpaid costs, TSI was taking the position that it was entitled to recover earned profit through the date of termination as well as substantial damages for the bad faith and wilful destruction of TSI as a company. TSI ultimately agreed to the $18 million settlement for the simple reason that TSI needed the money now and on the basis that $18 million was close to the present value of the known recovery of $26 million four or five years in the future after protracted litigation.

This was a hard fought lawsuit. The Navy was well represented by the Justice Department. Indeed, the depositions that were taken and filed, the records that were produced and the evidence summaries that were prepared and filed document the true TAO story. The final settlement was ultimately approved by the Navy, the Department of Justice, the AMSHIP Board of Directors, and the Federal Bankruptcy Judge.

In summary, there was no basis for the Default issued by the Navy. TAO 191 and 192 sit rusting and unfinished in the James River because the Navy didn't want the ships completed. Otherwise, it is inconceivable that the Navy did not accept George Steinbrenner's guarantee to complete the ships within the contract price, ships that were approximately 95% and 85% complete. In fact, the Navy should have terminated these contracts for the convenience of the Navy in July of 1993 when it knew that it didn't want the ships. The Navy's refusal to pay termination for convenience damages to TSI in July of 1993 probably resulted in a savings to the tax payers but also resulted in the total destruction of TSI. If TSI had had the financial resources to maintain its lawsuit against the Navy for four to five years, we believe the ultimate award would have been significantly greater than the $18 million settlement.

In closing I do want to clarify a misconception with regard to George Steinbrenner's so-called ownership of Tampa Shipyards. Tampa Shipyards, Inc. (TSI) is a wholly owned subsidiary of American Shipbuilding Company (AMSHIP). AMSHIP was a publicly traded company listed on the New York Stock Exchange. George M. Steinbrenner owned 10% of the stock of AMSHIP. Contrary to popular belief, Mr. Steinbrenner did not own AMSHIP. It was never "his company".

George Steinbrenner was never involved in the day-to-day operations of TSI. His primary contact with TSI operations personnel had to do with his responding to their requests for additional capital needs. Because of his intense desire to see the company succeed, he would always step forward and provide his own funds to keep the company afloat. He made these advances even though no bank, lending institution or other stock holder was willing to make the required loans.

Thank you for this opportunity to appear before you. I will attempt to answer any questions that you might have to the best of my ability.

Respectfully submitted,

TAMPA SHIPYARDS, INCORPORATED

BY: William R. Boyles, Jr.
William R. Boyles, Jr.
Vice President - Finance

STATEMENT OF

THE HONORABLE STEVEN S. HONIGMAN

GENERAL COUNSEL, DEPARTMENT OF THE NAVY

Mr. Chairman, distinguished members of the Subcommittee, thank you for this opportunity to appear before you to discuss the Navy's T-AO 187 Class Fleet Oiler Program.

In your press release, you expressed concern over the fact that two Navy oiler ships were never finished. Let me tell you why the Navy has not completed these ships. The T-AO 187 Class Fleet Oiler Program was inaugurated in 1979 to provide the Navy with 18 oilers to support a 600-ship Navy. Today we are talking about two of those eighteen ships. The reason these two ships were never completed has nothing to do with procurement but rather with operational requirements. While the procurement process, which you are addressing today, was going on, the world changed. With the end of the Cold War and the emphasis on downsizing, the Navy determined only 16 of the original 18 oilers were needed. These two oilers are single hulled, while the remaining oilers under construction are environmentally friendly double hulled. Therefore, since the contract for their construction had already been terminated, they were clearly the two ships to leave unfinished.

Concentrating on the history of these two ships obscures the fact that the entire T-AO program can serve as a case study of some of the best as well as the worst aspects of naval ship procurement. While we are certainly not proud of the performance of the Navy and the contractors on these two ships, we do feel that the T-AO program as a whole was a precursor to the present initiatives in acquisition reform. It was notable for incorporating commercial design and construction standards to an unprecedented extent in the early 1980's. The specifications were written in a format common to commercial ships and the contract terms and conditions were patterned largely after commercial-type contracts. The 18-ship program, spanning the time frame from concept inception in 1979 until the last ship delivery scheduled in 1996, is a major success story. However, even successful programs which follow required processes can have problems and even failures.

The T-AO 187 program incorporated maximum adherence to commercial design and construction standards. It was clearly recognized that few technological advances were required to construct a T-AO. Highly reliable commercial equipment and systems could satisfy the Navy's requirements. Moreover, prior to issuance of the solicitation, the Navy reviewed the terms and conditions with the intent of awarding a commercial-type contract and specification package. Toward this end, the Navy deleted contract clauses that were either cost drivers or served little purpose, and rewrote the remaining clauses so that they were understandable to the average person involved in shipbuilding. Compared to two previous Navy shuttle oiler class (AO 177) contracts, the total number of contract clauses was reduced from 118 to only 50 on the T-AO 187, and the number of military specifications were reduced by 90%. This total change in

contract and specification format convinced prospective shipbuilders that the Navy was serious regarding commercialization.

Now I would like to tell you about the complicated procurement process for the two ships at issue and why the Navy terminated the contracts associated with them for default. The Navy first procured the T-AOs in October 1982, when it awarded a competitive contract for the lead ship, T-AO 187 with options for three additional ships, to Avondale Shipyards ("Avondale") in New Orleans, Louisiana. Contract performance was an outstanding success story. The lead ship was designed, constructed, tested and delivered in 50 months; contract changes were held to an absolute minimum; and the program was under budget. In comparison to the AO 177 program which Avondale had completed shortly before award of the T-AO 187, it was 50% more ship for 75% of the cost. The same unheralded success story has carried through all of the 16 T-AOs which Avondale has produced.

The second group of T-AOs, consisting of seven ships, was awarded in fiscal year ("FY") 1985. At the time of this procurement, the Navy determined that it needed more than one producer of this class of ships to support the planned 600-ship Navy of the 1980's. As a result, the Navy awarded two contracts: one contract to the Pennsylvania Shipbuilding Company ("Penn Ship") for two ships with options for two more ships, and one contract to Avondale for one ship with options for two more ships.

The contract awarded to Penn Ship was plagued by a series of shipbuilder performance failures and has been the subject of much scrutiny. The solicitation stated that proposals determined to meet the minimum requirements of the solicitation would be evaluated for award on the basis of the overall lowest total target price proposed for the maximum possible quantity of ships including option ships.

Five shipbuilders submitted proposals in response to the solicitation. Penn Ship was the low offeror. In conformance with existing regulations, the Navy conducted a pre-award survey to assess Penn Ship's management, facilities, and financial capabilities. The pre-award survey team found that Penn Ship's management and facilities clearly supported a positive responsibility determination. A concern, however, arose regarding Penn Ship's financial capability and its relationship to its parent company, Capital Marine Inc. At the Navy's request, Peat, Marwick, Mitchell, & Co. performed an independent review of Penn Ship and Capital Marine Inc. financial data. Peat, Marwick, Mitchell, & Co. concluded that their review failed to reveal any evidence that would cause them to recommend against a contract award. The contracting officer considered this information as well as the following information when making his

responsibility determination: (1) Penn Ship was considered to be in a labor surplus area and had a two-tiered wage rate union agreement which added credibility to Penn Ship's apparently aggressive price proposal; (2) the Navy's pre-bid cost estimate was less than the contract ceiling price for which the Navy was contractually liable and at ceiling price the contractor would make a small profit; and (3) Penn Ship provided a trust indenture to pledge the assets of the shipyard as security for reprocurement in the event of a default. Therefore, the contracting officer determined Penn Ship to be a responsible contractor and, in accordance with the terms and conditions of the solicitation, awarded the contract to Penn Ship. The Navy exercised the options for the two additional ships in February 1986 and February 1987. The total target price of the contract was $414,486,628. The total ceiling price was $489,847,834.

Late in 1987, Penn Ship notified the Navy that it was experiencing financial difficulties. The Navy took various actions, such as releasing retentions, in an attempt to remedy Penn Ship's cash flow problems. At this time, the Navy also agreed that the assignment of ships to another shipyard was an alternative worth exploring.

In June 1988, the Navy agreed to the assignment of T-AO 194 and 196 to Avondale and modified Penn Ship's and Avondale's contracts accordingly. Specifically, the contracts were restructured from fixed-price-incentive with economic adjustments to firm-fixed-price contracts. The total firm-fixed-price of the two contracts represented the price to the Government had Penn Ship been able to complete performance under the original contract. This assumed that the contract cost grew to ceiling price, and included contractually required escalation payments, and other allowable cost increases.

Despite the assignment of T-AO 194 and 196, Penn Ship continued to encounter delays and overruns on its contract for the two remaining oilers (T-AO 191 and 192). In November, 1988, Penn Ship informed the Navy that continuing financial problems due to poor production efficiency was jeopardizing completion of the remaining two ships. The Navy believed that completion by another shipbuilder would be the most cost-effective method of completing the ships. Ultimately, the contract was terminated for default on August 28, 1989, after negotiation of a variety of issues including the amount and method of payment of the excess costs of reprocurement.

It is significant that the Navy entered into a negotiated settlement of the default termination. The Navy believes that this course of action minimized the cost of reprocuring the ships. It enabled the Navy to obtain title to a floating drydock with a resale value of $20 million. Had the Navy chosen an alternative course of action, such as a termination for default

with no settlement negotiation, there probably would have been a bankruptcy filing, substantial delays in recovering the ships, and litigation in the Court of Federal Claims challenging the default termination.[1]

During the termination negotiations with Penn Ship, the Navy requested quotes from three shipbuilders who were interested in completing the remaining two ships, the T-AO 191 and 192. Tampa Ship and Avondale submitted firm-fixed-price quotes, exclusive of material, while Bethlehem Steel refused to quote on a firm-fixed-price basis. Although Avondale was the low offeror by $3 million, the Secretary of the Navy determined there was a need to maintain the national industrial mobilization base for Underway Replenishment ships. The Assistant Secretary of the Navy for Shipbuilding and Logistics signed a Justification and Approval on November 16, 1989. The Navy subsequently awarded Tampa a $47 million fixed-price-incentive contract to complete these ships. A separate line item was established to procure additional material needed to complete the ships. Tampa was also required to provide a $3 million irrevocable letter of credit as a performance guarantee.

By 1991, there were signs that Tampa's financial condition was deteriorating. The Navy and Tampa had disagreements concerning responsibility for correction of deficiencies in work performed by Penn Ship and concerning the amount of material needed to complete the T-AOs. During this time period, the Navy solicited proposals to construct an Ocean Surveillance Ship (T-AGOS 23). Tampa was the lowest cost offeror judged to be technically acceptable. The pre-award survey, however, projected that Tampa would incur a significant loss on this contract. As a result, the contracting officer determined Tampa to be financially non-responsible to receive this award. In accordance with Federal Acquisition Regulation part 19.6, this determination was referred to the Small Business Administration ("SBA"). The SBA subsequently issued a Certificate of Competency which required the Navy to award the contract to Tampa. The Navy, however, required a $5 million irrevocable letter of credit as a performance guarantee.

In November 1991, the Navy issued a letter of concern to

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[1] Had Penn Ship filed for bankruptcy, the only secured source of funds would have been the $20 million provided by the trust indenture. Because Penn Ship provided the proposed approach, they also provided the document which was reviewed by the Navy. While the trust indenture and security instruments were never legally filed and perfected, the Navy believes that this did not affect the final outcome, because the Navy obtained title to a floating drydock which was valued at approximately the same amount as the trust indenture.

Tampa citing several problems and stating that trends indicated Tampa might not complete the T-AO ships on schedule. By March of 1992, the Navy had issued a cure notice which indicated still greater problems with Tampa's performance. In May 1992, Tampa submitted a request for extraordinary contractual relief under Public Law 85-804. In this action, Tampa requested approximately $24 million. It alleged that unless relief were granted, it would be unable to complete performance of the Navy's contracts and would be forced to seek protection in bankruptcy. Although the Navy recognized Tampa's poor financial condition, it believed that even if relief were granted, Tampa was not likely to complete the ships. Thus, the Navy denied the request.

In the FY 1993 Department of Defense Appropriations Act, Congress included a provision that granted financial relief in the amount of $58 million. The immediate effect was a cash infusion of approximately $25 million with the balance available to be earned for progress on the T-AOs. Of the $25 million, Tampa used $8 million as cash collateral for the two letters of credit serving as performance guarantees for the T-AOs and the Ocean Surveillance Ship. These letters of credit had previously been guaranteed by a major shareholder in Tampa. In addition, Tampa made a $2.2 million payment to the same major stockholder on an overdue loan. Thus, the $25 million cash infusion provided as a result of Congressional action resulted in Tampa's receiving only about $15 million with which to finance its operations.

Within one month of this infusion, Tampa sought Navy approval of a variety of plans to improve the company's cash flow. Despite approval by the Navy to make additional modifications to the contract in an effort to make Tampa more capable of completing the ships, Tampa continued to struggle financially. The Navy issued a second cure notice in July 1993. Tampa's response to this notice never satisfied the Navy's concerns, and the contract was terminated for default in August 1993.

As a result of Tampa's default, the Navy was faced once again with reprocurement of T-AO 191 and 192. On August 31, 1993, the Navy determined that T-AO 191 and 192 should be towed from Tampa's facility to an interim local facility as a precaution. Because the ships were not complete and not prepared for an ocean tow, they had to be towed to a local facility and properly prepared.

Tampa Shipbuilding, Inc. was allowed to arrange for the tow of the ships to Tampa Barge Services. Tampa was paid with funds from the operating escrow account. After the tow, Avondale Industries, Inc. performed the inspection, care, berthing services and tow preparation. It was anticipated that approval to negotiate with Avondale Industries, Inc. for the completion of T-AO 191 and 192 would be forthcoming. Of the 18 oilers

projected for the T-AO 187 class, Avondale currently has delivered 13 to the fleet. One ship has just completed Acceptance Trials, and two are under construction.

During this time, however, the Chief of Naval Operations ("CNO") was conducting an assessment of force level requirements. The CNO's review concluded that there was no longer a requirement for T-AO 191 and 192. As a result, it was determined that T-AO 191 and 192 should be prepared for lay-up and placed in the inactive reserve fleet rather than being completed. The ships were officially declared as excess by the Navy in November 1994 and are currently located at the Navy Inactive Fleet Facility, Portsmouth, Virginia. This saved the taxpayers money because the Navy did not spend more money on ships it did not need.

On November 1, 1993, several months after the Navy had terminated the T-AO contract for default, the Navy issued Tampa a cure notice under the T-AGOS 23 contract for Tampa's failure to sustain adequate progress. Tampa had all but ceased production on the T-AGOS 23 since the termination of the T-AO contract in August 1993. On November 4, 1993, Tampa voluntarily filed for protection under Chapter 11 of the United States Bankruptcy Code and filed a motion to assume both the T-AO and T-AGOS contracts. Under section 365 of the United States Bankruptcy Code, the debtor is allowed, subject to court approval, to assume or reject any executory contract of the debtor. In February 1994, the Bankruptcy Court ruled that Tampa could not assume the terminated T-AO contract because the contract had been terminated pre-petition and therefore was not executory. However, an evidentiary hearing to determine if Tampa was capable of asuming the T-AGOS 23 contract was scheduled for May 19, 1994 and then subsequently rescheduled for February 23, 1995. Tampa also filed a $32 million complaint (plus other unspecified amounts) against the Navy for termination costs of the T-AO contract in the Court of Federal Claims. Tampa's complaint stated that should Tampa prove unsuccessful in its motion to assume the T-AGOS contract, it would file an additional claim for consequential damages which it estimated to be in excess of $85 million.

On November 10, 1993, Tampa responded to the T-AGOS cure notice by stating that because the Bankruptcy Code dictates the terms and conditions under which an executory contract may be assumed, Tampa was not required to make any substantive response to the Navy's cure notice. As a result of the automatic stay imposed by the Bankruptcy Code, the Navy was prohibited from taking any adverse actions with respect to the T-AGOS contract and was required to wait upon the Bankruptcy Court to issue a determination regarding Tampa's assumption of the T-AGOS 23 contract. At the time Tampa filed for bankruptcy, the TAGOS-23 ship consisted of several partially completed modules and various parts which were located in Tampa's Westshore facility.

On March 25, 1994, Tampa presented a settlement proposal to the Department of Justice ("DOJ") and the Navy. Tampa's proposal included the following: the Navy pay Tampa approximately $25.8 million (based upon Tampa's estimated costs incurred but unpaid); the Navy stipulate that the T-AO contract was terminated by "mutual agreement" as opposed to "default"; the T-AGOS 23 contract be assigned to Halter Marine, Inc. for completion with the Navy to pay the increased price to complete; Tampa transfer T-AO and T-AGOS material on a cost-plus-fixed-fee basis; the Navy stipulate that Tampa can bid on future work; the Navy stipulate that the T-AGOS assignment was not as a result of wrongdoing or poor performance by Tampa, and; both parties execute mutual releases.

The Navy and DoJ viewed Tampa's proposal as unacceptable but informed Tampa that they would respond in detail. By letter dated June 22, 1994, Tampa conditioned its proposed assignment of the T-AGOS 23 contract to Halter Marine, Inc. on a satisfactory settlement of Tampa's claims against the Navy in connection with both contracts.

The Defense Contract Audit Agency ("DCAA") performed a comprehensive incurred cost audit for both the T-AO and T-AGOS contracts. The audit concluded that Tampa had incurred approximately $16.6 million in allowable and allocable unpaid costs under the T-AO contract and $8.6 million under the T-AGOS contract. This was much higher than the Navy's original estimate. The majority of the unpaid costs were a result of higher overhead rates incurred by Tampa but not billed to the Navy. While these higher overhead costs were allowable and allocable to the Navy contracts, they also exhibited Tampa's low efficiency.

DoJ provided its assessment of the litigative risks the Government faced regarding the claims asserted by Tampa. DoJ believed that the Government faced substantial difficulties sustaining default termination of the T-AO contract. This conclusion was based on the complex course of contract administration and the uncertainty of being able to sustain the Navy's side of may of the issues raised by Tampa. DoJ noted that if Tampa prevailed on its claim that the T-AO contract was wrongfully terminated, Tampa would likely also be successful on its claims regarding the T-AGOS contract. As a result of these considerations, the Navy decided to explore a settlement somewhere in the range of 50% of the Government's exposure.

DoJ and the Navy analyzed Tampa's damages claim, information within the Navy, and the DCAA audit results to determine the Government's potential exposure in the event the case went to trial and the Government lost. Since it was impossible to determine the extent of exposure with absolute certainty, the Navy and DoJ developed an exposure range using both Tampa's and

the Navy's calculations for a maximum and mid-range position.

At this time, Tampa was awaiting court approval of a reorganization plan under Chapter 11. Under this plan, a certain percentage of any proceeds from the Navy litigation would be paid to Tampa's creditors. The creditors' committee approved this plan under the stipulation that Tampa would not settle the Navy litigation for anything less than $20 million. If the settlement was less than $20 million, Tampa would have to go back to the creditors' committee for approval. Approval for a settlement of less than $20 million was considered doubtful, given that Tampa's attorney had told the creditors that he believed he could get a settlement in the range of $40 million. It became evident during the negotiations that Tampa would indeed settle for $20 million, which was within the Government's exposure range.

These exposure amounts were significantly different from the Navy's initial exposure calculations which were based upon projections for costs incurred but unpaid, and a loss ratio calculation under both the T-AO and T-AGOS contracts which was significantly changed by the DCAA audit.

Additionally, the Navy had maintained that the T-AO termination for default was correct and proper, and that Tampa would have sustained significant losses under both contracts. The Navy also had assumed that it could assess excess reprocurement costs under both the T-AO and T-AGOS contracts. The T-AOs, however, had by now been declared excess. It was also highly unlikely that a default termination of the T-AGOS contract could be sustained under these circumstances. Given this information, along with DoJ's conclusion that litigative risk existed, the Navy determined that it would be far cheaper to settle with Tampa and consent to the assignment of the T-AGOS than to reprocure the T-AGOS under normal circumstances.

Thus, on April 20, 1995, the Government and Tampa entered into a settlement of all controversies under the T-AO and T-AGOS contracts. The terms and conditions of the settlement consisted of the following: (1) Tampa and the United States execute mutual full and final releases; (2) Tampa seeks dismissal with prejudice of all pending court actions; (3) Tampa assumes the T-AGOS 23 contract under section 365 of the United States Bankruptcy Code and then assigns it to Halter Marine, Inc.; (4) The Navy, Tampa, and Halter Marine, Inc. execute modifications to the T-AGOS contract to increase the contract price and modify various terms and conditions; and (5) the United States pays Tampa a total of $18 million. The $18 million payment consists of the following funds: $1.2 million from TAO/TAGOS Escrow Account; $3.7 million from TAGOS Retentions; $3.3 million from TAO Retentions; and $9.8 million from the Judgment Fund.

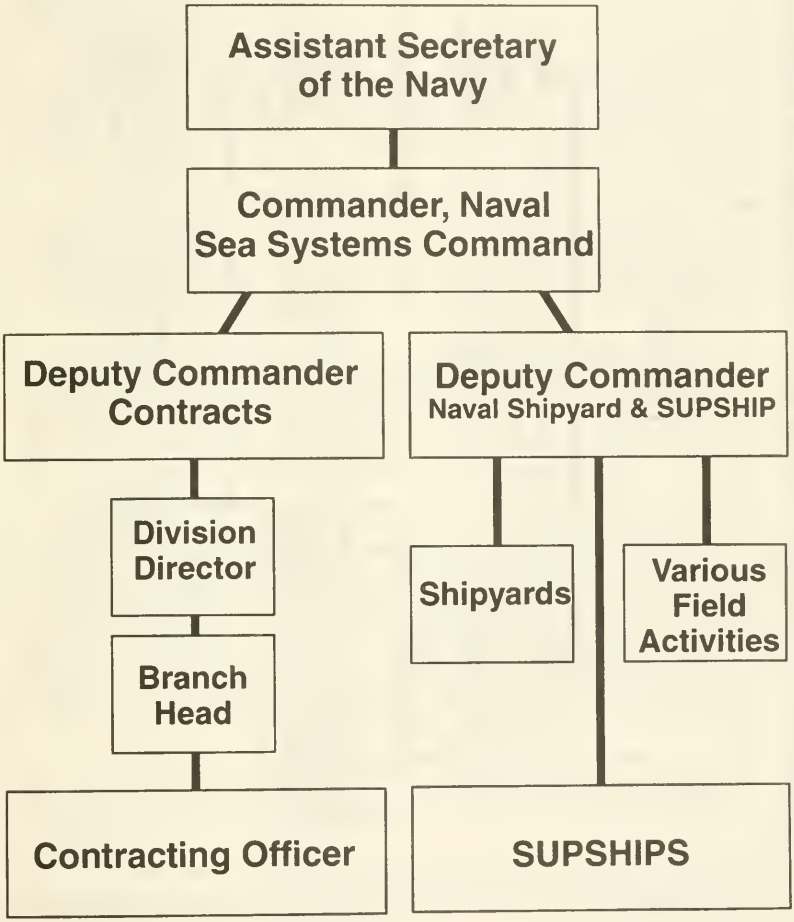
The Navy maintains that this was a good settlement. The

Navy pursued an aggressive defense and had independent analyses performed throughout the process. Tampa sought a lot more than they received. The settlement was ultimately entered into in the face of high risk.

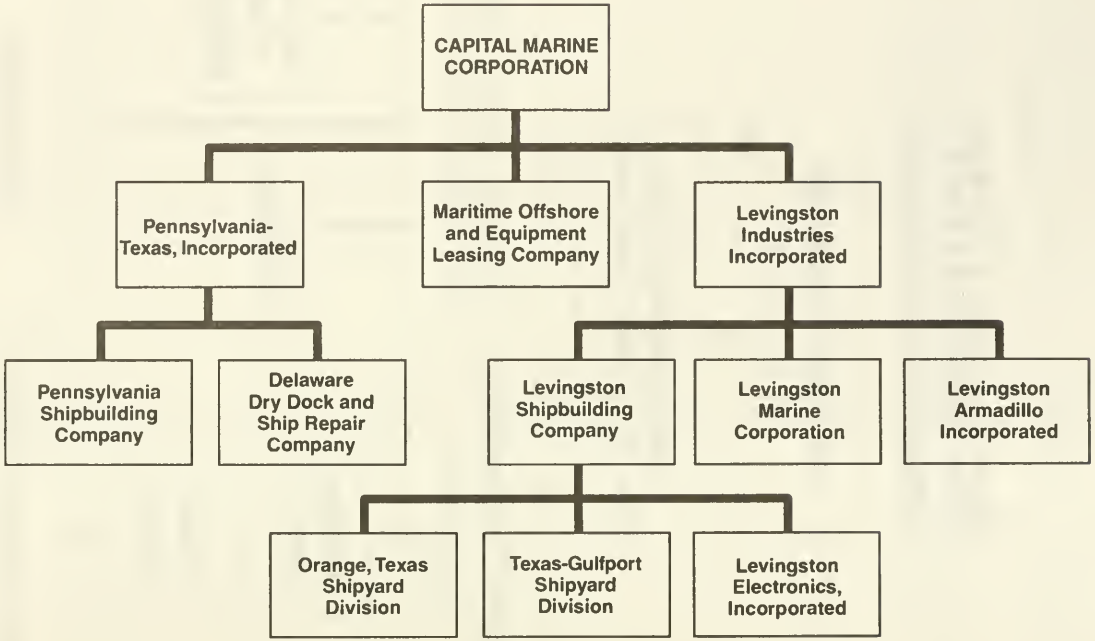
Finally, let me reiterate why the Navy never finished these two oilers. As you can see, the reason has nothing to do with the procurement process but rather with operational requirements. Simply stated, the world changed. The Navy no longer needed these two oilers to support a significantly reduced fleet at the end of the Cold War.

Senate Permanent Subcommittee
on Investigations
EXHIBIT # 1

Acquisition
Chain of Command



Capital Marine Corporation's Corporate Structure



Senate Permanent Subcommittee on Investigations
EXHIBIT # 2

OFFICE OF THE SECRETARY
WASHINGTON, D.C. 20350

13 December 1988

...ate Permanent Subcommittee
on Investigations

Exhibit - 3

Dear Mr. Chairman:

The Fiscal Year 1989 Appropriations Conference required that we perform an independent assessment of the shipbuilding industrial based and notify Congress before we award the construction contracts for the final three ships of the TAO 187 class fleet oilers. We have completed our assessment which I have attached.

We have just sufficient funds to make a three ship contract award to the competitively selected low offeror, Avondale Industries of New Orleans, Louisiana. A three ship award to the next low offeror would require a price premium exceeding $90 million, more than $30 million per ship. Funds to pay such a high premium of about 30% have not been appropriated by Congress for the TAO 187 program.

The root cause of the U.S. shipyards plight has been the near complete collapse of the commercial shipbuilding market in this country. This is of concern to both Congress and the Administration and has, of course, intensified the competition for Navy construction and repair contracts. In this instance, we do not project sufficient Navy work to ensure continued operation of all the yards who participated in this competition.

As our independent assessment on the shipbuilding industrial base shows, awarding to other than the low offeror is not warranted for mobilization. Of the five shipyards submitting bids for the TAO 187 contracts, two yards (including the low offeror) will remain open for the foreseeable future even without receiving the award of this three ship contract. Both shipyards will be available to compete for contracts in the FY 90 naval shipbuilding plan and either yard can easily accommodate the auxiliary vessels contained in the plan. Withdrawal of the other three shipyards from the industrial base would only have a minor effect on the mobilization scenario which assumes a long global high-intensity conventional war among superpowers.

In this era of constrained budgets, it is incumbent on us to avoid paying price premiums which are not warranted to maintain the industrial base. Accordingly, we intend to award the final three ships of the TAO 187 program to the low offeror, Avondale Industries.

If I can be of further assistance, please do not hesitate to let me know. I have sent a similar letter to [redacted]

Sincerely,

William L. Ball, III
Secretary of the Navy

ANALYSIS OF THE T-AO PROCUREMENT PLAN'S EFFECT ON THE AUXILIARY/AMPHIBIOUS/MERCHANT SHIPBUILDING MOBILIZATION BASE

ISSUE. The Conference Report on the FY 1989 Defense Appropriations Act directs the Secretary of the Navy to conduct an independent assessment of the shipbuilding mobilization base to determine whether or not the three remaining T-AO Fleet Oilers should be awarded to a second source.

BACKGROUND. The final seven ships of the T-AO 187 Class (FY88/89) were originally to be competed under a strategy of winner-take-all. The intent of this strategy was to minimize acquisition costs for completing the program. Following discussions with potential bidders, the Navy altered the T-AO acquisition plan to reflect a split award to both a primary and secondary source. The revised plan reflected an anticipated award of four ships (alternative "A") to the low offeror and three ships (alternative "B") to a different shipbuilder in the competitive process. The shipbuilder who receives the alternative "A" award was not eligible to receive award of alternative "B". Alteration of the procurement strategy was motivated by a desire to deter erosion of the non-combatant shipbuilding industrial base.

Avondale Industries Inc. (AII) was the low offeror for alternative "A" and was awarded a contract for one lead ship with options for three additional vessels. There were not sufficient funds for another shipbuilder to construct ships under alternative "B". Consequently, all bidders were requested to prepare best and final offers. Further, the solicitation was modified to permit the successful offeror under alternative "A" to be eligible for award of alternative "B" vessels. Best and final offers indicate that the price premium for other than the low offeror is more than $30M per ship, roughly 30% more than the low offer. The primary issue is whether maintenance of the industrial mobilization base justifies expenditure of the price premium noted herein.

DISCUSSION. The Shipbuilding Production Base Analysis (SPBA) provides an assessment of the ability of the shipbuilding industrial base to meet the mobilization, acquisition, activation, repair and attrition requirements of the Navy, Coast Guard and Maritime Administration. It assumes an undamaged U.S. industrial base and a conventional war scenario requiring completion of necessary shipbuilding, activation, repair and maintenance programs. The summer 1988 update of the SPBA concludes that ongoing work at D-Day can be successfully accelerated, activations can be accomplished, and all battle damage can be accommodated.

New construction requirements however cannot currently be met because of inadequate shipyard facilities, insufficient labor capacity, and the inability of supporting industries to fully satisfy shipbuilder demand for equipment. Although the shipyards have facilities to construct 81% of the required vessels, the limitations of labor and supporting industry drive ship deliveries down to 24% of the requirement.

As a subset of the shipbuilding and repair industrial base, there are currently nineteen shipyards which primarily build/repair auxiliary, amphibious and merchant ships. The combined recent employment of these yards is roughly 19,000 and, according to the shipyards themselves, they have the capability to expand to a maximum of 78,000 during a mobilization. Of these nineteen yards, five were involved in the bidding for alternative "B" vessels. They are as follows: AFI, Bethlehem Steel at Sparrows Point, National Steel Shipbuilding Co. (NASSCO), Tampa Shipyards, and Pennsylvania Shipbuilding Co. (PSC).

ANALYSIS. There are five shipyards currently building or converting major large auxiliary ships, NASSCO (AOE-6), AFI (T-AO, AO(J)), PSC (T-AO), Bethlehem Steel (T-AGS) and Tampa (T-ACS). Only eight other large auxiliary vessels are currently in planning for the POM 90 years (3 AOE, 1 AR, 1AH, T-AGS).

Analysis of workload curves for NASSCO and AFI indicate, even without award of alternative "B" vessels, that both have sufficient current work to ensure continued operation and allow for participation in competition for POM 90 ships. Similar analysis of workload curves for Tampa Ship, Bethlehem and PSC reveals that unless additional work is received immediately, prospects are very low that operations could be sustained long enough to facilitate respective competition for POM 90 vessels. Even with the award of alternative "B" to one of the shipyards at a minimum premium of 890K, demise of the remaining two yards would still occur. Clearly, there is insufficient work planned for the POM 90 years to justify keeping even one of the three facilities operational. Given the unlikely prospect that commercial work will become available, award of alternative "B" to Bethlehem, Tampa, or PSC would merely postpone what appears to be an inevitable restructuring of the mobilization base.

Closure of Tampa Shipyards, Bethlehem Steel and PSC would not affect the SPBA update with respect to battle damage and repair. The maximum mobilization labor force for the nineteen yards primarily engaged in auxiliary, amphibious and merchant ship work would be reduced by 24% (18,000 employees); peacetime manning

would decline by 15% (2700 employees). Minor impact would also be incurred with respect to total deliveries of new construction vessels in the scenario which accounts for limitations imposed by labor and supporting industry. Specifically, the mobilization new construction delivery shortfall would increase a total of 3% from 64% to 67%.

FINDINGS. The discussion and analysis presented herein supports the following findings:

- Avondale and MASSCO will remain open for the foreseeable future, even without receiving the award of alternative "B" vessels. Both shipyards will be available to compete for FCM 90 contracts and either yard can easily accommodate constructing the balance of FCM 90 vessels.

- Bethlehem Steel, Tampa Shipyards and PSC may discontinue operations in the near term without the award of alternative "B" vessels. The award of alternative "B" would sustain only one yard for a period of about three years at a minimum premium of $9CM with no firm prospect for economic viability beyond that point.

- Closure of Bethlehem Steel, Tampa Shipyards and PSC would have minimal overall impact (3%) on the mobilization delivery new construction shortfall. For the subset of shipyards building large auxiliary ships, the maximum mobilization labor base would be reduced by 34% and peacetime manning would incur a 15% decline.

- The premium for slowing erosion of the industrial mobilization base for three years totals a minimum of over $9CM. The premium of 30% over low offer is far greater than that the Navy has historically deemed justifiable to pay for protection of the industrial base.

RECOMMENDATION. Award the alternative "B" vessels to the low bidder.

[DEPARTMENT OF THE NAVY LETTERHEAD]

13 December 1988

Dear Mr. Chairman:

The Fiscal Year 1989 Appropriations Conference required that we perform an independent assessment of the shipbuilding industrial base and notify Congress before we award the construction contracts for the final three ships of the TAO 187 class fleet oilers. We have completed our assessment which I have attached.

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The root cause of the U.S. shipyards plight has been the near complete collapse of the commercial shipbuilding market in this country. This is of concern to both Congress and the Administration and has, of course, intensified the competition for Navy construction and repair contracts. In this instance, we do not project sufficient Navy work to ensure continued operation of all the yards who participated in this competition.

As our independent assessment on the shipbuilding industrial base shows, awarding to other than the low offeror is not warranted for mobilization. Of the five shipyards submitting bids for the TAO 187 contracts, two yards (including the low offeror) will remain open for the foreseeable future even without receiving the award of this three ship contract. Both shipyards will be available to compete for contracts in the FY 90 naval shipbuilding plan and either yard can easily accommodate the auxiliary vessels contained in the plan. Withdrawal of the other three shipyards from the industrial base would only have a minor effect on the mobilization scenario which assumes a long global high-intensity conventional war among superpowers.

In this era of constrained budgets, it is incumbent on us to avoid paying price premiums which are not warranted to maintain the industrial base. Accordingly, we intent to award the final three ships of the TAO 187 program to the low offeror, Avondale Industries.

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BACKGROUND. The final seven ships of the T-AO 187 Class (FY88/89) were originally to be competed under a strategy of winner-take-all. The intent of this strategy was to minimize acquisition costs for completing the program. Following discussions with potential bidders, the Navy altered the T-AO acquisition plan to reflect a split award to both a primary and secondary source. The revised plan reflected an anticipated award of four ships (alternative "A") to the low offeror and three ships (alternative "B") to a different shipbuilder in the competitive process. The shipbuilder who received the alternative "A" award was not eligible to receive award of alternative "B". Alteration of the procurement strategy was motivated by a desire to deter erosion of the non-combatant shipbuilding industrial base.

Avondale Industries Inc. (AII) was the low offeror for alternative "A" and was awarded a contract for one lead ship with options for three additional vessels. There were not sufficient funds for another shipbuilder to construct ships under alternative "B". Consequently, all bidders were requested to prepare best and final offers. Further, the solicitation was modified to permit the successful offeror under alternative "A" to be eligible for award of alternative "B" vessels. Best and final offers indicate that the price premium for other than the low offeror is more than $30M per ship, roughly 30% more than the low offer. The primary issue is whether maintenance of the industrial mobilization base justifies expenditure of the price premium noted herein.

DISCUSSION. The Shipbuilding Production Base Analysis (SPBA) provides an assessment of the ability of the shipbuilding industrial base to meet the mobilization, acquisition, activation, repair and attrition requirements of the Navy, Coast Guard and Maritime Administration. It assumes an undamaged U.S. industrial base and a conventional war scenario requiring completion of necessary shipbuilding, activation, repair and maintenance programs. The summer 1988 update of the SPBA concludes that ongoing work at D-Day can be successfully accelerated, activations can be accomplisned, and all battle damage can be accommodated.

New construction requirements however cannot currently be met because of inadequate shipyard facilities, insufficient labor capacity, and the inability of supporting industries to fully satisfy shipbuilder demand for equipment. Although the shipyards have facilities to construct 51% of the required vessels, the limitations of labor and supporting industry drive ship deliveries down to 34% of the requirement.

As a subset of the shipbuilding and repair industrial base, there are currently nineteen shipyards which primarily build/repair auxiliary, amphibious and merchant ships. The combined recent employment of these yards is roughly 19,000 and, according to the shipyards themselves, they have the capability to expand to a maximum of 75,000 during a mobilization. Of these nineteen yards, five were involved in the bidding for alternative "B" vessels. They are as follows: All, Bethlehem Steel at Sparrows Point, National Steel Shipbuilding Co. (NASSCO), Tampa Shipyards, and Pennsylvania Shipbuilding Co. (PSC).

ANALYSIS. There are five shipyards currently building or converting major large auxiliary ships. NASSCO (AOE-6), All (T-AO, AO(J)) PSC (T-AO), Bethlehem Steel (T-ACS) and Tampa (T-ACS). Only eight other large auxiliary vessels are currently in planning for the POM 90 years (3 AOE, 1 AR, 2AE, T-ACS).

Analysis of workload curves for NASSCO and All indicate, even without award of alternative "B" vessels, that both have sufficient current work to ensure continued operation and allow for participation in competition for POM 90 ships. Similar analysis of workload curves for Tampa Ship, Bethlehem and PSC reveals that unless additional work is received immediately, prospects are very low that operations could be sustained long enough to facilitate respective competition for POM 90 vessels. Even with the award of alternative "B" to one of the shipyards at a minimum premium of $90M, demise of the remaining two yards would still occur. Clearly, there is insufficient work planned for the POM 90 years to justify keeping even one of the three facilities operational. Given the unlikely prospect that commercial work will become available, award of alternative "B" to Bethlehem, Tampa, or PSC would merely postpone what appears to be an inevitable restructuring of the mobilization base.

Closure of Tampa Shipyards, Bethlehem Steel and PSC would not affect the SPBA update with respect to battle damage and repair. The maximum mobilization labor force for the nineteen yards primarily engaged in auxiliary, amphibious and merchant ship work would be reduced by 24% (18,000 employees), peacetime manning

would decline by 15% (2700 employees). Minor impact would also be incurred with respect to total deliveries of new construction vessels in the scenario which accounts for limitations imposed by labor and supporting industry. Specifically, the mobilization new construction delivery shortfall would increase a total of 3% from 64% to 67%.

FINDINGS. The discussion and analysis presented herein supports the following findings:

- Avondale and NASSCO will remain open for the foreseeable future, even without receiving the award of alternative "B" vessels. Both shipyards will be available to compete for POM 90 contracts and either yard can easily accommodate constructing the balance of POM 90 vessels.

- Bethlehem Steel, Tampa Shipyards and PSC may discontinue operations in the near term without the award of alternative "B" vessels. The award of alternative "B" would sustain only one yard for a period of three years at a minimum premium of $90M with no firm prospect for economic viability beyond that point.

- Closure of Bethlehem Steel, Tampa Shipyards and PSC would have minimal overall impact (3%) on the mobilization delivery new construction shortfall. For the subset of shipyards building large auxiliary ships, the maximum mobilization labor base would be reduced by 24% and peacetime manning would incur a 15% decline.

- The premium for slowing erosion of the industrial mobilization base for three years totals a minimum of over $90M. The premium of 30% over low offer is far greater than that the Navy has historically deemed justifiable to pay for protection of the industrial base.

RECOMMENDATION. Award the alternative "B" vessels to the low bidder.

Pennsylvania Shipbuilding

Pennsylvania Shipbuilding Company • P.O. Box 498 • Chester, PA 19016 • (215) 499-2000 • TELEX 834226

Senate Permanent Subcommittee
on Investigations
EXHIBIT 10

VIA TELECOPIER

November 15, 1988

Mr. Harold V. Hanson
Contracting Officer, (SEA 02222)
Naval Sea Systems Command
National Center #3, Room 5E57
2531 Jefferson Davis Highway
Arlington, VA 22202

Dear Harold:

As we pointed out to you in our meeting in your office on Wednesday, November 9, if Penn Ship is not able to obtain by 12:00 noon on Thursday, November 17, signed, approved invoices outstanding on T-AO 191 and T-AO 192 currently in the hands of our local Supships, (who cannot approve these invoices as submitted without your approval due to the unresolved vendor payables related thereto) we will have no alternative except to suspend operations indefinitely commencing Thursday night, due to cash flow shortages.

Rather than working expeditiously to develop a solution, this seems to us to be a very severe way of allowing events to dictate the outcome of a temporary but resolvable problem. We trust this is not anyone's intent and thus urge you to provide the necessary approval to our Supships as soon as possible.

By copy of this letter I am placing our work out and bankruptcy counsel on immediate alert to advise us of steps that we should take.

Sincerely,

R. J. Stevens
President

RJS:pbn

CC: LCDR W. B. Cole (Supship, Chester)
F. L. Sheridan (SEA 02B)
John Francis Gough (Hoyle, Morris & Kerr)

Pennsylvania Shipbuilding

Pennsylvania Shipbuilding Company • P.O. Box 496 • Chester, PA 19016 • (215) 499-2000 • TELEX 834220

VIA TELECOPIER

Senate Permanent Subcommittee on Investigations
EXHIBIT # 11

November 15, 1988

Mr. Harold V. Hanson
Contracting Officer, (SEA 02222)
Naval Sea Systems Command
National Center #3, Room 5E57
2531 Jefferson Davis Highway
Arlington, VA 22202

Dear Harold:

About 14 months ago, Penn Ship notified the Navy that it was experiencing cash flow problems on the T-AO program, and would have great difficulty completing the four ships then under contract unless some way was found to relieve these cash flow problems.

Through a long period of investigation, exploration and negotiation Penn Ship and the Navy reached a solution to the problem in May, 1988 about 8 months after first raising the issue, fully anticipating, however, that we might need to review the payments provisions of the revised contract at some future point, as noted in the following language taken from the contract:

"These payment provisions are intended to facilitate prompt payment of amounts owed to vendors, suppliers, and subcontractors and to provide sufficient funds for the orderly construction of the vessels and the performance of other essential tasks. The parties will periodically review the operations of these provisions and may agree to make changes if necessary to achieve these results."

Approximately six weeks ago, Penn Ship notified the Navy that cash flow had again become critical on the T-AO program, albeit the magnitude of the dollars involved is much less than it was one year ago.

During the past three months, Penn Ship expended about $20 million in cost on these ships and collected $13 million in revenues. Because of the limited working capital of the company, this $7 million disparity is creating severe cash flow problems.

Today, one ship is in the water and one is partially constructed, and there is about $70 million of contract value remaining to be expended.

Penn Ship presently forecasts a deficit of approximately $5 million in the T-AO program at completion, versus the remaining funds available to finish the ships. Through asset sales and other means, Penn Ship expects to be able to absorb this deficit. Our problem is that we are presently incurring the entire amount of this deficit now, instead of nearer the end of the program.

Penn Ship proposes that the interests of the Government and Penn Ship would both be better served if the potential deficit on this program were moved further into the future, providing us an opportunity to cure the problem and substantially reducing the potential impact of added costs to both Penn Ship and the Government compared to the prospect of suspending or curtailing operations today for lack of funding.

It is important to recognize that the problem today on this contract is principally one of the timing of funds. We do not believe that performance of the contract is beyond our financial capability, provided we can restructure the cash flow to more closely match costs and revenues.

That we might encounter this problem was not unexpected when we modified the contract in May, as evidenced by the language quoted above. However, we urge you to recognize that any delay at all in resolving this issue will result in substantial cost impacts for both the Government and Penn Ship.

Sincerely,

T. C. Weller, Jr.
Chairman of the Board

TCW:pbn

CC: F. L. Sheridan (SEA 02B)
CAPT C. J. Schrodt (Supship, Brooklyn)
LCDR W. B. Cole (Supship, Chester)

FOWLER, WHITE, GILLEN, BOGGS, VILLAREAL AND BANKER, P.A.

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DANA DUDEN YOUNG

Senate Permanent Subcommittee on Investigations
EXHIBIT # 12

VIA FEDERAL EXPRESS

May 31, 1995

Senator William V. Roth, Jr.
Chairman
Permanent Subcommittee on Investigations
United States Senate
100 Russell Senate Office Building
Washington, D.C. 20510

RE: TAO Investigation

Dear Senator Roth:

During the hearing on May 4, 1995 it was requested that Tampa Shipyards, Inc. respond to inquiries concerning the MARAD settlement and any lobbying activity in connection with the TAOs. Please accept this letter as Tampa Ship's response to that request.

The MARAD Settlement

The specific question that was asked was whether TSI offered to settle the MARAD Case for $3 to $4 million in response to MARAD's offer of $1.2 million. The answer is an emphatic NO!

By way of a brief summary, TSI was the lowest bidder on the MARAD contract. The work was performed and the ships were delivered to MARAD in February and May, 1989. The workmanship was considered to be excellent. However, TSI incurred a loss in excess of $18 million in performing this contract. It is significant that the Defense Contract Audit Agency performed an audit and confirmed TSI's loss. TSI submitted a proposal for

equitable adjustment in April, 1990. While that proposal was pending, TSI filed suit in the Federal District Court in Tampa.

During the course of trial preparation, settlement discussions did take place between TSI's attorneys and the Department of Justice Attorney representing MARAD. Prior to December, 1991, the Justice Department indicated that it would be unable to recommend settlement in excess of $1 million. After discussions with the Justice Department Attorneys by the then Chairman of the Board, Paul Butcher, it appeared that the Justice Department Attorneys were willing to recommend $3 million. In response, Admiral Butcher sent a settlement letter to William G. Leback, the Maritime Administrator at the time, which summarized the findings of TSI with regard to the serious losses incurred in the performance of this contract. A copy of Admiral Butcher's letter is attached hereto as Exhibit 1. Admiral Butcher ultimately offered to settle the claim for $5,943,496.00. The undersigned personally recalls discussing this proposal with Admiral Butcher. It was Admiral Butcher's position that the claim was worth far more than $5.9 million but that TSI needed the money now and could not afford costly litigation.

In response to Admiral Butcher's January 9th letter, the Justice Department Attorneys contacted TSI's attorneys and discussed "what-if proposals", i.e. what if TSI offered to settle for $4 million to $5 million and the Department of Justice offered $3 million. These were attorney discussions and certainly not intended to bind either of the principles.

Between January 9th and January 17, 1992 significant additional information and documentation was found by TSI's attorneys through the discovery process regarding MARAD's culpability in the occurrence of these cost overruns. On January 17, 1992 TSI's attorney contacted the Department of Justice Attorney verbally and in writing and withdrew any offers that the company had made, including the $5.9 million offer made by Admiral Butcher. Attached as Exhibit 2 is a copy of that letter.

Although the Department of Justice Attorneys later referred to a $4 million proposal by TSI in their letter of April 24, 1992, the fact remains that all of the TSI proposals for settlement had been rescinded in early 1992. The Department of Justice's final offer was reduced to $2.7 million, which offer was again summarily rejected by TSI.

The bottom line is that TSI's incurred costs in excess of $18 million were in fact confirmed by a DCAA Audit. The only formal TSI settlement offer made by Admiral Butcher was in the amount of $5.9 million based upon TSI's desperate need for cash. That offer was formally withdrawn by TSI within a month after it was made. The case was ultimately settled for $13.3 million which was approximately $5 million less than the actual loss sustained by TSI, as confirmed by the DCAA Audit.

The Activities of Paul Magliocchetti Associates, Inc.

In 1992 TSI contracted with Paul Magliocchetti Associates, Inc. (PMA) to make a quick assessment of TSI's ability to complete the two (2) TAO Oilers. Shortly thereafter, TSI, based upon the recommendation of the Navy's Contracting Officer initiated a PL85-804 Request for Extraordinary Relief. PMA assisted in the preparation of that request.

The next major involvement of PMA was triggered by the concern stated by the then Assistant Secretary of the Navy with regard to Tampa's ability to manage and execute the TAO Program. At TSI's request, PMA assembled a team of 11 senior experienced people, most of whom were retired Naval Officers, with experience in management, supervision of ship construction activities, ship operations, planning and finance.

As was requested by the Navy, a full briefing of the findings and recommendations resulting from the management study was provided by PMA to a group of senior Navy Officials including the Assistant Secretary. Because of the interest shown in this study by Congressmen and staff members, TSI expanded the PMA engagement to include Congressional briefings. It was at this time that PMA registered itself as a lobbyist for TSI and/or AMSHIP and remained in that status until the bankruptcy of AMSHIP and TSI.

Activities of Ragan and Mason

The Washington Lawfirm of Ragan and Mason has represented AMSHIP and TSI since the early 1980's and probably earlier. They have acted as TSI's Washington lawyers. They were actively involved in the handling of the MARAD lawsuit including the drafting of the original Complaint, the preparation of discovery requests and preparation of responses to discovery requests. They have consulted with TSI with regard to the construction of cruise ships, the conversion of sealift ships to automobile carriers, the double hull requirements for tankers, the sale of various ships, tall ship construction, the Navy's Fast Sealift Program, the Clean Air Act, the Federal Post-Employment Conflict of Interest Law and various and sundry other matters pertaining to the ship building industry and the Federal Laws, Rules and Regulations related thereto. In addition to acting as AMSHIP's and TSI's general corporate counsel in Washington, it is our understanding that Bill Ragan also registered as a lobbyist on behalf of AMSHIP and/or TSI. He did consult with TSI with regard to the TAOs and recommended and assisted TSI in securing a designation that it was in fact a small maritime business. It is our belief that Mr. Ragan also performed lobbying activities on behalf of TSI. We believe that he met with the Florida Congressional Delegation as well as other Senators and Congressmen and Navy and Department of Defense Officials.

We trust that this letter represents a full and complete response to the issues raised during the hearing on May 4, 1995.

Respectfully yours,

FOWLER, WHITE, GILLEN, BOGGS, VILLAREAL & BANKER P.A.

Robert E. Banker

Robert E. Banker
REB/od
enc.
cc/Harold Damelin

THE AMERICAN SHIP BUILDING COMPANY

EXHIBIT
/

PAUL D. BUTCHER
CHAIRMAN OF THE BOARD and CHIEF EXECUTIVE OFFICER

17 December 1991

Capt. Warren G. Leback
Maritime Administrator
US Department of Transportation
400 Seventh Street, SW
Washington, DC 20590

Via: Deborah Kosow, Esq.
Department of Justice
Torts Branch, Civil Division
Post Office Box 14271
Washington, DC 20044-4271

Dear Warren:

This is a follow-up letter to our meeting on 16 December 1991 with the Department of Justice and MARAD to discuss settlement of the T-ACS 7 and 8 Claim. While both parties worked well together, we did not agree on an equitable settlement. However, I would like to summarize our position as we presented it to your team and propose a final and equitable resolution to avoid costly and time consuming litigation for both parties.

After joining the company earlier this year, one of my immediate objectives was to reach resolution of this matter or commence vigorous pursuit of recovery of our cost of performance through the courts. In October 1991, I retained a legal counsel and a financial consultant, each of whom has over 20 years of government contract experience, to objectively evaluate the company's position to determine what should be an equitable settlement of this matter. They spent most of the following 60 days completing their legal and financial analysis prior to our meeting on December 16, 1991.

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TELEPHONE (813) 832-2121 • TELECOPIER (813) 832-2113

Their analysis concluded that the parties to the contract had experienced at least a mutual mistake with regard to the basic scope of work in the original contract, i.e., the unanticipated and extensive deterioration of the General Electric engines and turbines on both vessels and unanticipated steel deterioration particularly on T-ACS 8. The reason for this unanticipated deterioration was defective maintenance and de-humidification during NDRF deactivation storage. This rendered the original contract specification materially different from the actual scope of work required to upgrade the material conditions of these ships to the standards of RRF.

The unfortunate result of this mutual mistake was major unanticipated rebuilding of the engines and turbines and major unanticipated steel renewal. The effect on the contract was major delay, disruption and an unconscionable increase in the cost of performance. The courts have held that the legal remedy for mutual mistake is contract reformation to reflect what was actually experienced in contract performance. Accordingly, the courts have granted a contractor, under these circumstances, its reasonable cost of performance.

The financial analysis disclosed that no matter how the actual cost of performing this contract is calculated, the total cost was significantly higher than our original claim. Using the findings of the Defense Contract Audit Agency on this contract, regarding labor rates and actual overhead, we presented two methods of determining actual cost. The first method identifies the cost of performance to be $66,323,000 and the second method to be $68,707,000. Conservatively, we utilized the lower figure to determine our loss of $19,325,000. Your team argued that this figure did not take into consideration what the Contracting Officer identified as a low labor rate in the original bid plus any inefficiencies on the part of our company. For settlement purposes, we agreed that a judge may also take that into consideration and we deducted $3,323,000 to allow for these actions. Your team would not agree that this was sufficient. Again for settlement purposes, we subtracted an additional $4,115,008 which is 13% of the total contract labor hour cost and offered $11,886,992. I believe the judge would agree with this determination. However, although the company had previously made a one time revocable offer of $8,400,000 in April 1991, I agreed to decrease the figure to that amount for settlement purposes. Your team's final offer was $2,250,000 and my final offer was $6,800,000. The parties parted agreeing to cooperate on discovery and mutually beneficial exchanges of information.

Subsequent to the 16 December 1991 meeting, I have reviewed all of this information and remain willing and ready to settle this matter. In that regard, I hereby offer you a settlement amount of $5,943,496 payable to our company which is half of what we anticipate our recovery will be through the trial process. However, it is emphasized that this is only 30% of our loss on this contract.

Please contact me with your response prior to December 31, 1991 which is the expiration date of this offer. This offer is solely for settlement purposes and is not binding or an admission of any kind.

Sincerely,

Paul D. Butcher

PDB:vt

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EXHIBIT
2

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ALBANY, NEW YORK

January 17, 1992

JOHN H. HORNE
PARTNER

BY FAX

Ms. Debra J. Kossow
Senior Admiralty Counsel
Torts Branch, Civil Division
U.S. Department of Justice
Post Office Box 14271
Washington, D.C. 20044-4271

Re: Tampa Shipyards, Inc. v. United States of America

Dear Debbie:

Being unable to contact you by telephone I am faxing this to your office to be there upon your return from Germany. As a result of our recent review of MARAD's documents I must withdraw my most recent settlement offer. Also, in view of this new information, I find it inappropriate to submit to you at this time a written summary of our position as we discussed at our meeting on January 9. However, I am agreeable to meet with you to discuss this new information. Since we have the deposition on Friday morning I can make myself available to meet with you Thursday afternoon. I will be in my office in Atlanta on Monday to discuss this.

Very truly yours,

OGLETREE, DEAKINS, NASH,
SMOAK AND STEWART

John H. Horne

JHH:LRW

DEPARTMENT OF THE NAVY
NAVAL SEA SYSTEMS COMMAND
WASHINGTON DC 20362 5101

Senate Permanent Subcommittee on Investigations
EXHIBIT # 13

J&A No: 12,843
PR No: N00024-89-PP-2384
Code: 02231
Date: 16 NOV 1989

JUSTIFICATION AND APPROVAL
TO PROCURE USING OTHER THAN FULL AND OPEN COMPETITION

Upon the basis of the following justification, I hereby approve as Senior Procurement Executive of the Navy, the solicitation of the proposed contract described below using other than full and open competition pursuant to the authority of 10 U.S.C. 2304(c)(3).

JUSTIFICATION

1. Contracting Activity:

Naval Sea System Command, Shipbuilding Division, SEA 02231

2. Nature of Action Being Approved:

Contracting without providing for full and open competition.

3. Description of Supplies/Services:

The proposed contract will provide for the detailed design and construction of the T-AO 191/192 Fleet Oilers. Associated on-board spare and repair parts and technical manuals will also be procured with the ships. This contract is the reprocurement action for contract N00024-85-C-2115. The anticipated target cost is $44 million with a target profit of $2 million. The anticipated ceiling price is $49 million. The share ratio will be established at 50/50. The total program cost of the T-AO 191/192 is anticipated to be $412,600,000.

4. Statutory Authority:

10 U.S.C. 2304(c)(3) - Industrial Mobilization.

5. Rationale Supporting Use of Citation in No. 4:

The strategy for the reprocurement of the T-AO 191/192 is based on the need to maintain the national industrial mobilization base for Underway Replenishment (UNREP) ships. By letter dated 13 December 1988, the Secretary of the Navy forwarded to Congress the Navy's "Analysis of the TAO Procurement Mobilization Base" (Analysis). This Analysis was provided as required by the FY 1989 Defense Appropriations Act, which directed the Secretary of the Navy to conduct the analysis to determine whether or not the three remaining T-AO Fleet Oilers (Alternative "D" of the FY88 procurement) should be awarded to a second source.

The Analysis noted that there are five shipyards currently building or converting major large auxiliary ships: Avondale Industries, Inc., Bethlehem Steel at Sparrows Point, National Steel and Shipbuilding Co. (NASSCO), Tampa Shipyards, and Pennsylvania Shipbuilding Co.

The Analysis of workload curves for NASSCO and Avondale showed that both have sufficient work to ensure continued operation and allow for participation in competition for POM 90 ships. A similar analysis of workload curves at Bethlehem, PSC and Tampa indicated that unless additional work is received immediately, prospects are low that operations could be sustained long enough to allow the shipyards to compete for POM 90 vessels. The Analysis further indicated that an award of the alternative "B" T-AOs "...would merely postpone what appears to be an inevitable restructuring of the mobilization base." The Analysis concluded the closure of Bethlehem, PSC and Tampa would not affect the Shipbuilding Production Base Analysis update with respect to battle damage and repair.

The Analysis was based on the assumption that both Avondale and NASSCO were solid competitors for the POM 90 ships. However, with respect to NASSCO, circumstances have changed significantly subsequent to the time of the Analysis. At the time the Analysis was performed, NASSCO was a wholly owned subsidiary of Morrison-Knudsen Co. (MK), an engineering and construction conglomerate. As of April 1989, however, NASSCO is no longer a part of MK, but rather is an independent company owned by the company's employees through an Employee Stock Option Plan. As a result of this change in ownership and the accompanying loss of financial support by MK, NASSCO is not nearly as solid a competitor as it was at the time the Analysis was performed. NASSCO must both increase productivity and obtain new work or its viability as a competitor will be in jeopardy within two years. If NASSCO were to cease being a competitor in two years, Avondale would effectively be left as the sole remaining source for large auxiliary ships. Further, the condition of the three remaining shipyards has also markedly deteriorated. Therefore, the industrial base for large auxiliary ship construction is not secure.

One additional recent development is the potential appropriation by Congress for ships exceeding the POM. The HAC report to the FY 90 DOD Appropriation Bill proposes a Fast Sealift Program which, if enacted, based upon preliminary assessments would create more auxiliary/amphibious work than could be accomodated by the combined capabilities of AII and NASSCO. While completion of the T-AO 191/192 is a two-year effort, and could sustain a yard's operation only for that period rather than the four year effort envisioned for the three complete ships discussed in enclosure (1), award of this effort to a financially unstable company like Tampa could serve as a company "bridge" to new work under the proposed Fast Sealift Program.

In view of the circumstances discussed above, it will be in the interest of the national defense to maintain another shipyard as a viable competitor for POL 90 years and for any additional work due to a Fast Sealift Program. The award of a contract to Tampa for the completion of the T-AOs will ensure Tampa's viability for the near term. Thus, in the event that NASSCO is not able to effectively compete in two years, or if there is more work then could be handled by Avondale and NASSCO there will be an alternative source of competition at that time. Of the remaining shipyards which could be maintained, an award of completion of the T-AO 191 and T-AO 192 to Tampa is considered the most cost effective means (less than a five percent premium with respect to the total program contract cost) to maintain a viable industrial mobilization base for large auxiliary ship construction in the near term of two years.

6. Synopsis or Other Efforts for Sources:

A synopsis is not required for the reprocurement of the subject vessels, because reprocurements are not subject to publication requirements applicable to regular procurements.

7. Contracting Officer's Determination of Fair and Reasonable Projected Cost:

The Contracting Officer has determined that the anticipated cost to the Government will be fair and reasonable.

8. Market Survey Information:

A formal market survey was not conducted; however, by letter of 6 April 1989, the Navy requested a written quote from those companies which had expressed an interest in the possible reprocurement of the T-AO 191/192 - Avondale Industries, Inc., Bethlehem Steel Corporation, and Tampa Shipyard Inc..

9. Other Information:

The delivery of the T-AO 191 will be no later than one (1) year after contract award. The T-AO 192 will be delivered no later than two (2) years after contract award.

10. List of Other Interested Sources:

With the exception of those companies from which quotes were requested by NAVSEA, there has been no other expressed interest in this aquisition.

11. Future Plans to Permit Competition:

There are no future plans to procure additional T-AO ships.

TECHNICAL AND REQUIREMENTS CERTIFICATION REQUIRED BY FAR 6.303-2 (b)

I certify that the facts and representations under my cognizance which are included in this justification and its supporting Acquisition Plan No. 274-81 Revision 2 dated May 1988, and which form a basis for this justification are complete and accurate.

Technical Cognizance:

Name and Title	Code	Phone	Date
John P Archbald Project Manager	PMS 393A3	692 3512	11/16/89

Requirements Cognizance:

Name and Title	Code	Phone	Date
Project Manager	PMS 383	692 5507	11/16/89

CONTRACTING OFFICER CERTIFICATION REQUIRED BY FAR 6.303-2(a)(12)

I certify that this justification, including its supporting Acquisition Plan No. 274-81 Revision 2 dated May 1988, is accurate and complete to the best of my knowledge and belief.

Name and Title	Code	Phone	Date
	SEA0223	692-3772	11/16/89

APPROVAL BLOCK REQUIRED BY 6.304

APPROVED:

Name and Title	Date
FRANK W. SWOFFORD By Direction of the Secretary of the Navy	11/16/89

PREAWARD SURVEY OF PROSPECTIVE CONTRACTOR (GENERAL)

1. SERIAL NO. *(For surveying activity use)*

FORM APPROVED OMB NO. 3090-0110

SECTION I – REQUEST *(For Completion by Contracting Office)*

2. NAME AND ADDRESS OF SURVEYING ACTIVITY

Sea Systems Command
Sea 074
Washington, D.C. 20362

3. SOLICITATION NO.

4. TOTAL OFFERED PRICE

$

5. TYPE OF CONTRACT

6A. NAME AND ADDRESS OF SECONDARY SURVEY ACTIVITY *(For surveying activity use)*

NAVSHIPSO, Philadelphia, Pa
SUPSHIP Portsmouth, Portsmouth, VA.
PMS 383, NAVSEA

7. NAME AND ADDRESS PROSPECTIVE CONTRACTOR

Pennsylvania Shipbuilding
Chester, PA

Senate Permanent Subcommittee on Investigations
EXHIBIT # 16

6B. TELEPHONE NO. *(Include autovon, Wats/FTS, if available)*

202 692-3505

8. WILL CONTRACTING OFFICE PARTICIPATE IN SURVEY?

[X] YES [ ] NO

9. DATE OF THIS REQUEST

10. DATE REPORT REQUIRED

11. Prospective contractor represents that it [ ] is, [ ] is not a small business concern.

12. WALSH-HEALEY CONTRACTS ACT *(Check applicable box (es))*

[ ] A. IS NOT APPLICABLE

[ ] B. IS APPLICABLE AND PROSPECTIVE CONTRACTOR REPRESENTS HIS CLASSIFICATION AS:

[ ] MANUFACTURER [ ] REGULAR DEALER

[ ] OTHER *(Specify)*

13. NAME AND ADDRESS OF PARENT COMPANY *(If applicable)*

14. PLANT AND LOCATION *(If different from Item 7, above)*

15A. NAME OF REQUESTING ACTIVITY CONTRACTING OFFICER

.TURE

16A. NAME AND ADDRESS OF SECONDARY REQUESTING ACTIVITY *(For surveying authority use)*

15C. TELEPHONE NO. *(Include autovon, Wats/FTS, if available)*

16B. TELEPHONE NO. *(Include autovon, Wats/FTS, if available)*

17. FIRM'S CONTACT FOR SURVEY

A. NAME AND TITLE

Mr. Tim Colton, V.P. Marketing

B. TELEPHONE NO. *(Include Area Code)*

SECTION II – DATA *(For Completion by Contracting Office)*

18A. ITEM NO.	18B NATIONAL STOCK NUMBER (NEW) AND NOMENCLATURE		18C. TOTAL QUANTITY	18D. UNIT PRICE	18E. DELIVERY SCHEDULE (a)	(b)	(c)	(d)	(e)
		SOLICITED							
		OFFERED		$					
		SOLICITED							
		OFFERED		$					
		SOLICITED							
		OFFERED		$					
		SOLICITED							
		OFFERED		$					
		SOLICITED							
		OFFERED		$					
		SOLICITED							
		OFFERED		$					
		SOLICITED							
		OFFERED		$					
		SOLICITED							
		OFFERED		$					
		SOLICITED							
		OFFERED		$					

NSN 7540-01-140-5525 1403-101 STANDARD FORM 1403 (10-83)

SECTION III – FACTORS TO BE INVESTIGATED

Column (a) is for request. Columns (b) and (c) are for survey results. Provide a narrative explanation substantiating each factor for which Column (b) or (c) is checked.

19. MAJOR FACTORS	CHK. (a)	SAT. (b)	UN-SAT. (c)	20. OTHER FACTORS (Provide specific requirements in Remarks)	CHK. (a)	SAT. (b)	UN-SAT. (c)
A. TECHNICAL CAPABILITY	X			A. GOVERNMENT PROPERTY CONTROL	X		
B. PRODUCTION CAPABILITY	X			B. TRANSPORTATION	X		
C. QUALITY ASSURANCE CAPABILITY	X			C. PACKAGING	X		
D. FINANCIAL CAPABILITY				D. SECURITY	X		
E. ACCOUNTING SYSTEM				E. PLANT SAFETY	X		
				F. ENVIRONMENTAL/ENERGY CONSIDERATIONS	X		
				G. OTHER (Specify)			

21. IS THIS A SHORT FORM PREAWARD REPORT?

☐ YES ☒ NO

22. IS A FINANCIAL ASSISTANCE PAYMENT PROVISION IN THE SOLICITATION?

☐ YES ☒ NO

23. REMARKS

SECTION IV – SURVEYING ACTIVITY RECOMMENDATIONS

24. RECOMMEND

☐ A. COMPLETE AWARD

☐ B. PARTIAL AWARD (Quantity _____)

☐ C. NO AWARD

25A. NAME AND TITLE OF SURVEY APPROVING OFFICIAL

Algernon J. Fortier

PRE-AWARD SURVEY COORDINATOR

25B. TELEPHONE NO.

303-692-3505

25C. SIGNATURE

25D. DATE

1/30/85

PREAWARD SURVEY OF PROSPECTIVE CONTRACTOR TECHNICAL

SERIAL NO. *(For surveying activity use)*

FORM APPROVED OMB NO. 3090-0110

PROSPECTIVE CONTRACTOR

Penn Ship

...llowing information in narrative, or attach continuation on sheets of paper if necessary.
...ev personnel.

Names, qualifications/experience and length of affiliation with prospective contractor.

Evaluate technical capabilities with respect to the requirements of the proposed contract or item classification.

Description of any technical capabilities which the prospective contractor lacks. *(Comment on the prospective contractor's efforts to obtain the needed technical capabilities.)*

4. FIRM HAS AND/OR UNDERSTANDS	YES	NO
a. Specifications	X	
b. Exhibits	X	
c. Drawings	X	
d. Technical data requirements	X	

Give explanation for any items marked "NO" in 5. Narrative.

NARRATIVE

See survey summary , "Section C".

6. SURVEY MADE BY	a. SIGNATURE *(Include typed or printed name)*	b. OFFICE	c. TELEPHONE NO. *(Include area code)*
	PMS 383		d. DATE

NSN 7540-01-142-0133 1404-101 STANDARD FORM 1404 (10-83) Prescribed by GSA

PREAWARD SURVEY OF PROSPECTIVE CONTRACTOR PRODUCTION	SERIAL NO. (For reporting activity use)	FORM APPROVED OMB NO. 3090-0110
	PROSPECTIVE CONTRACTOR: Penn Ship	

SECTION I -- ORGANIZATION AND MANAGEMENT DATA

Allowing information in narrative or attach continuation on sheets of paper if necessary.

1. Describe the relationship between management, production, and inspection. Attach an organizational chart, if available.

2. Describe the prospective contractor's production control system. State whether or not it is operational.

3. Evaluate the prospective contractor's production control system in terms of (a) historical effectiveness, (b) the proposed contract, and (c) total production during performance of the proposed contract.

4. Comment on or evaluate other areas unique to this survey (include all special requests by the contracting office and any other information pertinent to the proposed contract or item classification).

5. NARRATIVE

See survey summary, "Sections A, D. G and H".

SECTION II – PLANT FACILITIES

1. SIZE OF TRACT	4. DESCRIPTION AND TYPE OF BUILDING(S)
2. SQUARE FEET UNDER ROOF / 3. NO. OF BUILDINGS	[X] OWNED / [ ] LEASED (Give expiration date) — See survey summary, "Sections J, K and L".

5. SPACE					6. MISCELLANEOUS PLANT OBSERVATIONS		
	TYPE	SQUARE FEET	ADEQUATE	INADEQUATE	(Explain any items marked "NO" on an attached sheet.)	YES	NO
MANUFACTURING	a. Total manufacturing space				a. Good housekeeping maintained		
	b. Space available for offered item				b. Power and fuel supply adequate to meet production requirements		
					c. Alternate power and fuel source available		
STORAGE	c. Total storage space				d. Adequate material handling equipment available		
	d. For inspection lots						
	e. For shipping quantities				e. Transportation facilities available for shipping product		
	f. Space available for offered item				OTHER (Specify) f.		
	g. Amount of storage that can be converted for manufacturing, if required				g.		
					h.		

SECTION III – PRODUCTION EQUIPMENT

LIST MAJOR EQUIPMENT REQUIRED (Include GFP and annotate if as such)	QUANTITY REQUIRED FOR PROPOSED CONTRACT	TOTAL QTY. REQD DURING LIFE OF PROPOSED CONTRACT	QUANTITY ON HAND	CONDITION (a) G	F	P	QUANTITY SHORT* (Col. (c) minus (d))	SOURCE, IF NOT ON HAND	VERIFIED DELIVERY DATE
(a)	(b)	(c)	(d)				(f)	(g)	(h)
1. MANUFACTURING	See survey summary, "Section K".								
2. SPECIAL TOOLING									
3. T / SPECI									

* Coordinate shortage information for financial implications.

STANDARD FORM 1405 (10-83)

SECTION IV – MATERIALS AND PURCHASED PARTS

1. PARTS/MATERIALS WITH LONGEST LEAD TIME

DESCRIPTION (a)	SOURCE (b)	VERIFIED DELIVERY DATE TO MEET PROD. (c)
See survey summary, "Sections I and J".		

2. DESCRIBE THE MATERIAL CONTROL SYSTEM, INDICATING WHETHER IT IS CURRENTLY OPERATIONAL, AND EVALUATE ITS ABILITY TO MEET THE NEEDS OF THE PROPOSED ACQUISITION.

See survey summary, "Sections F, G and I".

SECTION V – SUBCONTRACTING

HOW MUCH OF THE TOTAL PROPOSED CONTRACT WILL BE SUBCONTRACTED? ▶ ○ %

DESCRIPTION OF SUBCONTRACT ITEMS (a)	SOURCE (b)	VERIFIED DELIVERY DATE TO MEET PROD. (c)

SECTION VI – PERSONNEL

1. NUMBER AND SOURCE OF EMPLOYEES

TYPE OF EMPLOYEES	NO. ON BOARD	ADD. NO. REQUIRED	AVAIL. YES	AVAIL. NO	SOURCE
a. Skilled Production	845	1100			LOCAL HIRE
b. Unskilled Production					
c. Engineering					
d. Administrative					
e. TOT. (Lines a, b + c)					

2. SHIFTS ON WHICH WORK IS TO BE PERFORMED
☒ FIRST ☐ SECOND ☐ THIRD

3. UNION AFFILIATION
International Boilermakers

AGREEMENT EXPIRATION DATE ▶ 1/7/89

4. RELATIONSHIP WITH LABOR INDICATES PROBLEMS AFFECTING TIMELY PERFORMANCE OF PROPOSED CONTRACT (If "Yes," explain on attached sheet)
☐ YES ☒ NO

SECTION VII – DELIVERY PERFORMANCE RECORD

Satisfactory

SECTION VIII – RELATED PREVIOUS PRODUCTION (Government)

PAST YEAR PRODUCTION		GOVERNMENT CONTRACT NUMBER 1/	PERFORMANCE		QUANTITY	DOLLAR VALUE (8000)
ITEM NOMENCLATURE (a)	NATIONAL STOCK NO. (FSCM) (b)	(c)	ON SCHED. (d)	DELINQUENT (e)	(f)	(g)
urvey summary, ...tion A".						

1/ Identify identical items by an asterisk (*) after the Government contract number.

SECTION IX – CURRENT PRODUCTION

(Government and civilian concurrent production schedule using same equipment and/or personnel as offered item.)

ITEM(S) (Include Government Contract No., if applicable. Identify unsatisfactory performance with asterisk (*).)	MONTHLY SCHEDULE OF CONCURRENT DELIVERIES (Quantity)										
	1st	2nd	3rd	4th	5th	6th	7th	8th	9th	10th	BAL.
1. BEING PRODUCED N/A											
2. PRE AV											

SECTION X – RECOMMENDATION

1. RECOMMENDED

[X] a. COMPLETE AWARD [ ] b. PARTIAL AWARD (Quantity: _____) [ ] c. NO AWARD

2. REMARKS (Cite those sections of this report which substantiate the recommendations. List any other backup information in this space or on attached sheet if necessary. Identify any formal systems reviews and state results.)

See survey summary.

If continuation sheets attached – mark here [ ]

	a. SIGNATURE AND OFFICE (Include typed or printed name)	b. TELEPHONE NO. (Include area code)	c. DATE SIGNED
3. SURVEY E			
4. SURVEY REVIEWING OFFICIAL	a. SIGNATURE AND OFFICE (Include typed or printed name) Algernon Y. Santos. PRE AWARD SURVEY Coord.	b. TELEPHONE NO. (Include area code) 202-692-3505	c. DATE REVIEWED 1/30/85

STANDARD FORM 1405 (10-83)

PREAWARD SURVEY OF PROSPECTIVE CONTRACTOR QUALITY ASSURANCE

If more space is required, continue on the back in Section IV or attach continuation sheets.

FORM APPROVED OMB NO. 3060-0110
SERIAL NO. (For computer or data use)

SECTION I – GENERAL

1. PROSPECTIVE CONTRACTOR: PENN SHIP
2. LOCATION: Chester, PA

SECTION II – COMPANY AND SOLICITATION DATA

1. QUALITY ASSURANCE ORGANIZATION (Describe briefly and attach organization chart.)

See survey summary

2. QUALITY ASSURANCE OFFICIALS CONTACTED (Names, titles, and years of quality assurance experience)

3. QUALITY RELIABILITY, MAINTAINABILITY REQUIREMENTS WHICH APPLY

MIL-I-45208	MIL-C-45662	☐ OTHER (Specify)
MIL-I-45007	MIL-STD-785	
MIL-Q-9555	MIL-STD-470	

4. IDENTICAL OR SIMILAR ITEMS HAVE BEEN ☐ PRODUCED ☐ SERVICED BY PROSPECTIVE CONTRACTOR.

SECTION III – EVALUATION CHECKLIST

STATEMENTS	YES	NO
1. AS PERTAINS TO THE CONTRACT, THESE ITEMS ARE UNDERSTOOD BY THE CONTRACTOR — a. Exhibits, technical data, drawings, specifications, and approval requirements	X	
b. Preservation, packaging, packing, and marking requirements	X	
c. OTHER (Specify)	X	
2. Records available indicate that the prospective contractor has a satisfactory quality performance record during the past twelve (12) months for similar items.	X	
3. Used or reconditioned material and former Government surplus material will be furnished by the prospective contractor. *(If Yes, explain in Section IV, on the back of this form.)*	X	
4. Prospective contractor will require unusual assistance from the Government.		X
5. Did prospective contractor fulfill commitments to correct deficiencies, as proposed on previous surveys, when awarded that contract?		X
6. Quality control, inspection, and test personnel. (NUMBER SKILLED / NUMBER SEMI-SKILLED)	[redacted]	X
7. Inspection to production personnel ratio. (RATIO)	[redacted]	
The following are available and adequate. (If not applicable, show "N/A" in "Yes" column.)		
8. Inspection and test equipment, gages, and instruments for first article and production (including solicitation specified equipment).	X	
9. Calibration/metrology program.	X	
10. Written procedures and instructions for inspections, tests, process controls, and other requirements; conformance thereto; in conjunction with other planning control functions.	X	
11. Control of specifications, drawings, changes and modifications, work/process instructions.	X	
12. Quality assurance/control organizational structure.	X	
13. System for determining inspection, test, and measurement requirements	X	
14. Controls for selecting qualified supplies and assuring the quality of purchased materials	X	
15. Material control: identification, segregation, maintenance, preservation, and correction of defects	X	
16. Government furnished property controls	X	

NSN 7540-01-149-8527 — 1406-101 — STANDARD FORM 1406 (10-83) Prescribed by GSA, FAR (48 CFR) 53.209-1(d)

SECTION III – EVALUATION CHECKLIST – STATEMENTS, Continued	YES	NO
17. In-process inspection controls.		
18. System for timely identification and correction of deficiencies to prevent recurrence.		
19. Preservation, packaging, packing, marking controls.		
20. Quality control records (such as, inspection, test, corrective actions, calibration, etc.		
21. Controls for investigation of customer complaints and correction of deficiencies.		
22. Reliability and/or maintainability program.		

SECTION IV – QUALITY ASSURANCE RECOMMENDATIONS

1. RECOMMEND ☐ AWARD ☐ NO AWARD *(Provide full explanation for recommendation)*

If more space is needed, use plain paper, identify continued item(s), and attach to this form. NO. OF PAGES ATTACHED, IF ANY ☐

2. SURVEY MADE BY (Include signature, typed/printed name, and office)	3. TELEPHONE NO. (Include area code)	4. DATE SUBMITTED

5. REVIEWING/APPROVING OFFICIAL (Include signature, typed/printed name, and office)	6. DATE APPROVED	7. HIGHER AUTHORITY (Explain)
[signature]	1/30/85	

STANDARD FORM 1409 BACK (10-83)

PRE-AWARD SURVEY OF OFFEROR PART V—MONITOR REPORT	OFFEROR: PENN SHIP CHESTER, PA	SERIAL NUMBER	Form Approved OMB No. 22-R0253

1. IS OFFEROR INCLUDED ON THE CONSOLIDATED LIST OF DEBARRED, INELIGIBLE, AND SUSPENDED OFFERORS, OR ANY OTHER CURRENT CONTROL LIST? *(If "yes", identify list and state reason for inclusion thereon)*

No

2. WHAT FORMAL SYSTEM REVIEWS HAVE BEEN PERFORMED? RESULTS?

N/A

3. DOCUMENTATION OF COMMITMENTS. IF AN OFFEROR PLANS TO ACQUIRE ADDITIONAL RESOURCES ESSENTIAL TO PERFORMANCE OF THE PROPOSED CONTRACT, DOCUMENT SUCH COMMITMENTS OR ATTACH A COPY OF THE OFFEROR'S STATEMENT OF INTENT.

N/A

4. DOES THE OFFEROR HONOR HIS COMMITMENTS? ☐ YES ☐ NO. FURNISH NARRATIVE INFORMATION TO DOCUMENT OFFEROR'S FAILURE TO MEET COMMITMENTS ON PREVIOUS CONTRACTS.

./A

5. BASED ON ALL INFORMATION RECEIVED, RECOMMEND: ☒ COMPLETE AWARD ☐ PARTIAL AWARD *(Quantity _____)*
☐ NO AWARD. *(Provide brief justification for your recommendation to the pre-award survey review board. Use reverse if more space is required.)*

SEE SUMMARY

MONITOR *(Signature and office)*	PHONE AREA CODE AND NO.	DATE
[signature] NAVSEA PRE-AWARD SURVEY Code	202-692-3505	1/30/85

FORM DD, APR 73 1524-5 PREVIOUS EDITION IS OBSOLETE. S/N 0102-015-2350

A16442

A. MANAGEMENT ORGANIZATION AND SYSTEMS

The offerers management organization and systems were reviewed in great depth and detail with discussions conducted with the top company officials and the review of such documents as organization charts and other pertinent data being utilized.

The review did not indicate any areas which would hinder the company's satisfactory performance under the requirements of the solicitation. Management has an understanding of the solicitation, sufficient management and control systems and master scheduling system in place, which should lead it to satisfactory performance if awarded the contract.

B. LABOR RELATIONS/EMPLOYMENT PRACTICES

Penn Ship's Industrial Relations Division is headed by a well qualified individual, with a sufficient staff to enable him to accomplish the Division's work. This division would have no problems bringing on board the personnel needed if Penn Ship receives the contract.

Past experience and the current labor market indicate that sufficient personnel are locally available. Also, there are current or planned training programs sufficient to indoctrinate new employees or ungrade current employee, that will enhance skills.

The company has just signed a four year contract with the employee's union. (Int. Boilermakers). This is considered a definite plus, as work stoppages should be held to a minimum.

C. TECHNICAL (DESIGN) ORGANIZATION AND PERSONNEL

A concern exists in the offerer's Engineering Organization, both current, and projected.

Penn Ships understanding of the availability of detail construction drawings was that either the Navy or ASI would furnish them. This is not the case. If Penn Ship cannot obtain/buy the package, they are required to develop them.

Penn Ship now understands this requirement but the survey team is of the opinion that Penn Ship does not appreciate the full magnitude of the undertaking. Not only would they have to employ a Design Agent (probably J. J. Henry), but would have to Q.A. the results. The current staff is considered insufficient for this task, but they fully intend to augment their staff.

D. TECHNICAL CONTROL SYSTEMS/PROCEDURES

The offeror's technical control systems and procedures are considered adequate for the purposes of this solicitation. The only concern, as detailed in Section C, is that of an inadequate Engineering force to cover technical problems/QA with subcontractors.

In-house reporting/control is extensively computerized, leading to real time information being available as required.

entered into the system. Key personnel prerequisites are outstanding and the needs of the department in case of award of this contract, have been studied and solved.

J. MATERIAL PLANNING SCHEDULING AND CONTROL

Penn Ship facility and existing system lends itself to the successful accomplishment of this procurement. Problem areas identified are moderate in degree and identified as (1) Use of subcontractor draftsmen to prepare material requisitions and specification and (2) Uncertain access to lead yard prepared drawings. It appears that Penn Ship should be able to delegate responsibility of prep or requisitions and specs to in-house personnel or develop those capabilities. The drawings matter should not be discussed at this point.

K. FACILITIES

Penn Ship's plant facilities and equipment appear to be in good shape and there is a maintenance program to keep them that way. There are adequate facilities and equipment to support the work which is required on the TAO project and any additions or improvements would only enhance work on the project.

L. WATERFRONT SERVICES

This full service shipyard should have no problems providing these facilities, services and equipment required for the purpose of the procurement. The only identified potential problem area would be the required fire flooding alarm systems if Penn decides to try to engineer the system themselves in lieu of buying a package system.

M. MATERIAL PROTECTION OF PROPERTY

The full-time 26 security force at Penn Ship, patrols approximately 185 acres that is fully controlled by guard access gate and full perimeter fence. Roving patrols during each shift provide security at fence and waterfront areas. A badge system for identification of plan personnel, subcontractor and visitors is mandated at all times. Hazardous materials and potential environmental problems are adequately address in the written and implemented safety program.

N. SAFETY

Penn Shipyard has a fully operational safety program that includes new employee indoctrination, special hazardous operations training, safety manual, safety/fire protection procedures and supervisory safety training. A well stocked dispensary is operated in-house along with a fire brigade and fire truck/ambulance. Recent OSHA violations were minimal and agreed upon by both parties. The accident rate of 0.40 is good and shows the overall effectiveness of the program. No risks are identified in this area.

E. TESTS, TRIALS AND LOGISTICS SUPPORT

A review of the offerer's approach to tests, trials, logistics support was made and found to meet the requirements of the solicitation and of the NAVSEA total ship test program.

Penn Ship demonstrated recent tests and trial plans for other programs. They more than met the requirements.

The company proposes to utilize the services of a contractor to provide ILS support. The company (Booz-Allen) has extensive experience in this field.

F. QUALITY ASSURANCE

Penn Ship is considered to be fully capable of complying with all quality requirements of the proposed TAO project. They have a fully staffed QA organization with qualified personnel and very qualified management individuals. Most written procedures are already in place and those that are not can easily be developed. There are some concerns in the areas of subcontract control and calibration. More emphasis should be placed on auditing subcontractors and firming up a total subcontractor administration program and on making production personnel aware of the necessity to use calibrated tools and equipment and keeping the calibrations current.

G. PRODUCTION ORGANIZATION

The general set-up of both management and tradesmen function at Penn Ship is considered to be a strong point. Necessary functions are properly placed with normal lines of communications in both directions. The production effort is augmented by several systems of checks and balance that is staffed by knowledgeable personnel. The training effort is considered to be innovative with built-in plans for improvement. Historical problems noted by customers have been identified by this contractor and effort for improvements have been verified thru those customers. A more active participation by upper management into the everyday operation on all levels is a plus.

H. PRODUCTION PLANNING AND CONTROL

This reviewer is impressed with the Penn Ship effort in this area. The proven Japanese Shipbuilding methods have been adopted into a computer assisted program that depends upon the tradesmen area coordinators to produce methods of estimating, planning, tracking and identifying problem areas. This system works and it appears to adopt itself to many modes, including this proposed solicitation. On added plus to this program is the exacting schedule of events that lead to critical path/milestones progression.

I. MATERIAL ORGANIZATION AND SYSTEMS

Penn Ship's general material department organization is adequate as arranged and staffed. System problems are minor, have been identified and corrective actions addressed. The computer assisted system contains many attributes that ensure quick accurate procurement. Normal in-house inventories are kept and entered into the computer, this memory capability not only identifies in-house stock but suggest that inventory of new items be

GUARANTY

To: EMPLOYERS CASUALTY COMPANY As of December 31, 1984

In order to induce you, EMPLOYERS CASUALTY COMPANY, to extend financial accommodation to CAPITAL MARINE CORPORATION (the "Debtor"), the undersigned, intending to be legally bound, guarantees absolutely the full and prompt payment to you of that certain Promissory Note of the Debtor dated as of December 31, 1984 in the principal amount of $3,748,688, together with such interest as may accrue thereon before or after maturity and all other amounts payable thereunder (collectively, the "Obligation"), and all expenses of obtaining payment thereof or endeavoring to enforce this guaranty, including court costs and reasonable attorneys' fees.

This guaranty shall be an absolute and unconditional guaranty and may be enforced by you without first making demand upon or proceeding against the Debtor or others liable on the Obligation, and without first resorting to any security or invoking other available rights or remedies. The undersigned waives notice of any default with respect to the Obligation.

This guaranty shall be binding upon the undersigned and its respective successors and assigns, and shall inure to the benefit of you and your successors or assigns. No waiver of your rights hereunder, or any modification hereof, shall be effective unless in writing, signed by your authorized officer, and each waiver shall extend only to the specific instance involved and shall not impair your rights in any other respect at any other time.

Although referred to as guaranty, this instrument is intended to be a contract of Suretyship, upon which the undersigned intends to be legally bound. This agreement shall be governed by the laws of the Commonwealth of Pennsylvania.

PENNSYLVANIA SHIPBUILDING COMPANY

By _____
Title: Chairman

Senate Permanent Subcommittee on Investigations
EXHIBIT # 17

GUARANTY

To: TEXAS EMPLOYERS' INSURANCE ASSOCIATION

As of December 31, 1984

In order to induce you, TEXAS EMPLOYERS' INSURANCE ASSOCIATION, to extend financial accommodation to CAPITAL MARINE CORPORATION (the "Debtor"), the undersigned, intending to be legally bound, guarantees absolutely the full and prompt payment to you of that certain Promissory Note of the Debtor dated as of December 31, 1984 in the principal amount of $445,517 with such interest as may accrue thereon before or after maturity and all other amounts payable thereunder (collectively, the "Obligation"), and all expenses of obtaining payment thereof or endeavoring to enforce this guaranty, including court costs and reasonable attorneys' fees.

This guaranty shall be an absolute and unconditional guaranty and may be enforced by you without first making demand upon or proceeding against the Debtor or others liable on the Obligation, and without first resorting to any security or invoking other available rights or remedies. The undersigned waives notice of any default with respect to the Obligation.

This guaranty shall be binding upon the undersigned and its respective successors and assigns, and shall inure to the benefit of you and your successors or assigns. No waiver of your rights hereunder, or any modification hereof, shall be effective unless in writing, signed by your authorized officer, and each waiver shall extend only to the specific instance involved and shall not impair your rights in any other respect at any other time.

Although referred to as guaranty, this instrument is intended to be a contract of Suretyship, upon which the undersigned intends to be legally bound. This agreement shall be governed by the laws of the Commonwealth of Pennsylvania.

PENNSYLVANIA SHIPBUILDING COMPANY

By: [signature]
Title: CHAIRMAN

Senate Permanent Subcommittee on Investigations
Exhibit # 17

Exhibit C (Part 1 of 2)

Senate Permanent Subcommittee on Investigations
EXHIBIT # 18

PROMISSORY NOTE

$3,748,688

As of December 31, 1984

CAPITAL MARINE CORPORATION (the "Undersigned") hereby promises to pay to the order of EMPLOYERS CASUALTY COMPANY (the "Payee") at its offices in Dallas, Texas the sum of Three Million Seven Hundred Forty-Eight Thousand Six Hundred Eighty-Eight Dollars, payable with interest at the rate of 10% per annum. Principal and interest shall be payable in consecutive monthly installments of $90,000 each commencing April 15, 1985 and continuing on the 15th of each month thereafter until September 15, 1985, when the entire unpaid principal balance of this Note, together with accrued but unpaid interest thereon, shall be due and payable. After default the unpaid principal balance of this Note shall accrue interest at the rate of 10% per annum.

This Note, any renewals and extensions thereof, and any other obligations to the Payee, due or to become due or which may hereafter be contracted by the Undersigned, are collectively referred to herein as "Liabilities."

Any one of the following events shall constitute a default hereunder: (i) the failure to pay when due any amount payable on any of the Liabilities; (ii) the failure of the Undersigned or any guarantor of this Note to perform any agreement of any nature whatsoever with the Payee or any subsidiary or affiliate of the Payee; (iii) the occurrence of any event of default under that certain promissory note of the Undersigned payable to Texas Employers' Insurance Association in the amount of $445,517, dated as of December 31, 1984; (iv) an application is made for the appointment of a trustee or receiver for, or any assignment for the benefit of creditors is made by, or a petition under any of the provisions of the federal Bankruptcy Code is filed by or against, or there occurs any other act of insolvency (however expressed or indicated) by the Payee or any guarantor of this Note; (v) any representation, warranty or information heretofore or hereafter furnished to the Payee in connection with any of the Liabilities shall be false in any material respect.

If any event of default should occur: (i) all Liabilities shall be immediately due and payable without notice or demand on the Undersigned or any guarantor of this Note, whether or not such Liabilities are otherwise then due and payable; (ii) the Payee shall have the right, immediately and without further action by it, to set off against the Liabilities, all monies or other property owed by the Payee in any capacity to the Undersigned, whether or not due, and the Payee shall be deemed to have exercised such right and to have made a charge against any such money immediately upon the occurrence of such default, even though such charge is made or entered on the books of the Payee at a subsequent time.

The Undersigned agrees to reimburse the Payee for all costs, including reasonable attorneys' fees incurred to collect any and all sums due hereunder. The Payee hereby waives presentment, demand for payment, notice of dishonor, protest and notice of protest, and any or all other notices or demands in connection with this Note. The liability of the Payee shall be unconditional without regard to the liability of any other party and shall not be in any manner affected by any indulgence whatsoever granted or consented to by the Payee, including but without being limited to any release of any party, extension of time, renewal, waiver or other modification. Any failure of the Payee to exercise any right hereunder shall not be construed as a waiver of the right to exercise the same or any other right at any time and from time to time thereafter.

Any notice to the Undersigned shall be sufficiently served for all purposes if placed in the mail addressed to, or left upon the premises at the address shown below.

All issues arising hereunder shall be governed by the laws of Pennsylvania.

Address:

CAPITAL MARINE CORPORATION

By: _____ (SEAL)
Title: President

MORGAN, LEWIS & BOCKIUS
COUNSELORS AT LAW
2000 ONE LOGAN SQUARE
PHILADELPHIA, PENNSYLVANIA 19103
TELEPHONE (215) 963-5000
CABLE ADDRESS MORLEBOCK
TELEX 83-1246

WASHINGTON
NEW YORK
LOS ANGELES
MIAMI
HARRISBURG
LONDON

LAWRENCE H. BERGER
DIAL DIRECT (215) 963-5560

Senate Permanent Subcommittee on Investigations
EXHIBIT # 19

August 28, 1985

Ralph P. Johnson
Vice President
Employers Casualty Company
1301 Young Street
Dallas, TX 75221

Dear Ralph:

I am pleased to report that Mr. Weller returned this afternoon to our offices and executed the Promissory Notes and Guaranties. The originals of each of the four documents signed by Mr. Weller are enclosed.

Concerning the collateral for these obligations Mr. Weller told me that he had thought further about the subdivision situation and concluded that Pennsylvania Shipbuilding would need to subdivide the 66 acres anyway. Accordingly, he said that he would be willing to grant a mortgage now on the 6 acre segment of the 66 acre parcel, provided that such an arrangement would not subject Pennsylvania Shipbuilding to any serious penalties for violation of the local subdivision ordinance. He told me that he would be happy to provide you with a written promise to obtain approval for the subdivision. As we discussed, I am getting more information about the subdivision restrictions and will contact you once I have that information.

Very truly yours,

Lawrence H. Berger

pds
enclosures

DEPARTMENT OF THE NAVY
NAVAL SEA SYSTEMS COMMAND
WASHINGTON DC 20362-5101

Senate Permanent Subcommittee on Investigations
EXHIBIT # 20

IN REPLY REFER TO
4200
Ser 02C3/057

[redacted]

MEMORANDUM

From: Christopher D. Pigott (SEA 02C3)
To: John A. Kimener (SEA 0224)

Subj: FINANCIAL RESPONSIBILITY OF PENNSYLVANIA SHIPBUILDING COMPANY

Ref: (a) Audited Financial Statements for Pennsylvania Shipbuilding Company and Delaware Drydock and Ship Repair Company for the years ended 30 Sept 83 and 84
(b) Interim Financial Statement for Pennsylvania Shipbuilding Company for the 3 months ended 31 Dec 84
(c) Audited Financial Statements for Pennsylvania-Texas Incorporated and Subsidiaries for the years ended 30 Sept 83 and 84
(d) Agings of Accounts Receivable as of 18 Jan 85
(e) Agings of Accounts Payable as of 31 Dec 84
(f) Industrial Valley Bank and Trust Company letter dated 28 Jan 85
(g) Backlog of Government and Commercial Work as of 31 Dec 84
(h) Audited Financial Statement for Capital Marine Corporation and Subsidiaries for the year ended 30 Sept 84
(i) Audited Financial Statement for Paden, Inc. and Subsidiaries for the year ended 30 Sept 84
(j) Audited Financial Statement for Maritime and Offshore Equipment Leasing Company for the year ended 30 Sept 83
(k) Audited Financial Statement for Levingston Industries, Inc. and Subsidiaries for the years ended 30 Sept 83 and 84
(l) Pennsylvania Shipbuilding Company letter dated 29 Jan 85
(m) Dyer & Ellis letter dated 6 Feb 85
(n) Hand, Arendall, Bedsole, Greaves & Johnston letter dated 10 Feb 85.

1. The following is a review of the financial responsibility of Pennsylvania Shipbuilding Company (Penn Ship) to complete a contract for the construction of up to nine second flight T-AO 187 class ships under solicitation N00024-84-R-2223(Q). The findings herein are largely based on financial information obtained during a pre-award survey conducted at Penn Ship on 22 and 23 January 1985.

2. A review of references (a) through (g) indicates that Penn Ship is in a positive financial condition. The following chart summarizes several key financial indicators obtained from references (a) and (b) for Penn Ship from accounting year 1983 to the present.

Subj: FINANCIAL RESPONSIBILITY OF PENNSYLVANIA SHIPBUILDING COMPANY

	INTERIM 1985 (3 mos. ending 31 Dec 84)	1984 (Audited)	1983 (Audited)
Working Capital ($)	4,998,346	3,835,668	2,924,194
Current Ratio	1.24	1.27	1.26
Net Worth ($)	6,700,019	6,934,933	5,407,968
Debt to Worth Ratio	3.98	2.96	3.15
Sales ($)	13,688,876	79,073,285	64,810,279
Net Income ($)	(234,913)	(1,623,035)	1,995,484

3. The above figures for working capital and the current ratio indicate that Penn Ship is in a good position to meet its short term obligations. The fact that the company's working capital has increased over time also signifies that the cushion of safety for creditors is good. An analysis of Penn Ship's recent agings of accounts receivable and payable in references (d) and (e) indicates a good cash flow and thereby further supports the company's short term liquidity. Only 2.6 percent of the accounts receivable and 2.1 percent of the accounts payable on 31 December 1984 were 90 days or more past due.

4. An analysis of Penn Ship's overall financial condition (short and long term obligations combined) is also positive. The company's positive net worth since 1982 indicates that it has been able to maintain solvency. Its debt to worth ratio, however, is high, which means Penn Ship is highly leveraged (more capital is being contributed by its creditors than by its owners). A firm which is highly leveraged is generally more limited in its ability to acquire additional financing than one that is not. Nevertheless, Penn Ship currently has an available line of credit of $2.5M with the Industrial Valley Bank and Trust Company (IVB); and, as discussed in reference (f) and in a phonecon with Mr. Smedley, a Vice President at IVB, is attempting to acquire additional outside financing of up to $15-20M for use as working capital on the T-AO program. Mr. Smedley has informed NAVSEA that this additional financing has a good likelihood of being approved if Penn Ship receives a T-AO contract.

5. Penn Ship's sales record over the past two years has been on an upward trend but profits have not been particularly good. The company was profitable in 1983 but suffered a loss in 1984. According to Mr. W. Jarrett, the Penn Ship Controller, this loss is misleading. In order to reduce the taxes owed to the state of Pennsylvania, Penn Ship pays its parent company (Capital Marine Corporation which is incorporated in the state of Texas) a consulting fee which reduces the company's reported income. This process is addressed in note 12 of reference (a) for the year ended 30 September 1984. According to Penn Ship this is a proper

Subj: FINANCIAL RESPONSIBILITY OF PENNSYLVANIA SHIPBUILDING COMPANY

accounting technique and is a common practice among Pennsylvania businesses. If this technique were not used by the company, its net income in 1984 would have been approximately $1.0M. Mr. Jarrett stated that in reality this fee is never paid to the parent company but is instead returned within a year to Penn Ship by the parent company as additional paid in capital. For the first three months of accounting year 1985, Penn Ship also experienced a net income loss, but it is too early in the new accounting year to determine whether this will ultimately result in a loss at the end of the year. Penn Ship has stated that all its current work is projected to be profitable by the time of completion. The backlog of both Government and commercial work as of 31 December 1984 was $48.28M, as noted in reference (g), with total profits during 1985 estimated at approximately $3.6M by the Controller.

6. In order to conduct a comprehensive review of Penn Ship's financial position a review of the financial condition of its parent company, Capital Marine Corporation (formerly Paden, Inc.), is also necessary. The results of the review of Capital Marine are not as positive as is the case with Penn Ship as the following chart of financial indicators obtained from references (h) through (k) reveals.

	1984 (Audited)	1983 (Audited)
Working Capital ($)	(11,453,444)	1,661,662
Current Ratio	.65	1.10
Net Worth ($)	(2,248,163)	1,780,475
Debt to Worth Ratio	-	25.95
Sales ($)	85,739,313	86,901,891
Net Income ($)	(4,778,638)	2,180,811

7. The above figures indicate that Capital Marine had a working capital shortage, general insolvency, and an earnings loss at the end of accounting year 1984. Further analysis reveals the major driver behind these negative statistics is the present financial situation at Levingston Industries, Inc. (Levingston), another subsidiary of Capital Marine. Levingston operates independently of Penn Ship and these two companies are affiliated through their common ownership by Capital Marine. Due to a significant decline in business and the resultant financial difficulties associated with this downturn, Levingston is having serious financial problems. At the end of accounting year 1984, the company had a working capital total of ($6,986,256), a net worth of ($5,570,658) and a net income of ($8,149,912). These negative statistics more than offset the positive contributions made by Penn Ship to Capital Marine's financial posture. It should be noted Penn Ship has informed NAVSEA that, if Levingston must be liquidated, its property in Texas is valued at approximately three times its present indebtedness according to American Appraisers.

Subj: FINANCIAL RESPONSIBILITY OF PENNSYLVANIA SHIPBUILDING COMPANY

8. NAVSEA's major concern regarding the financial difficulties of Levingston and Capital Marine is the impact these difficulties could have on Penn Ship's ability to perform under a T-AO contract, especially if Levingston goes into a Chapter 11 bankruptcy. In response to NAVSEA's concern Penn Ship has provided two documents prepared by the company's legal counsel, Dyer and Ellis of Washington, D.C., which analyze the financial obligations which exist between Penn Ship, Capital Marine and Levingston. With regard to the obligations existing between Penn Ship and Levingston, Dyer and Ellis has concluded in reference (l) that, "each of the Levingston Acquisition Documents and the Penn Ship Acquisition Documents reflect separate and independent financial undertakings of Levingston and Penn Ship, respectively, such that no assets or obligations of Penn Ship are pledged or committed to secure the performance of Levingston under the Levingston Acquisition Documents and that no assets or obligations of Levingston are pledged or committed to secure the performance of Penn Ship under the Penn Ship Acquisition Documents." Furthermore, as explained in note 7 of reference (a) for the year ended 30 September 1984, the loan convenants established for the acquisition of Sun Ship, Inc. by Penn Ship prohibit Penn Ship from making loans or investments in any affiliated corporations. With regard to the relationship between Capital Marine and Levingston, Dyer and Ellis has concluded in reference (m) that Capital Marine is under "no contractual obligations or liabilities either as a borrower or as a guarantor under the Penn Ship Acquisition Documents or under the Levingston Acquisition Documents..." In addition, Capital Marine's legal counsel states in reference (n) that Capital Marine should not be liable for the debts and obligations of Levingston except in a case where the parent company specifically undertakes a liability for Levingston. According to the audited financial statements for 1983 and 1984, as discussed in references (h) and (i), Capital Marine has not undertaken a liability for Levingston, nor, according to Tom Weller, Capital Marine's President and Chief Executive Officer, have they during the present accounting year. This does not necessarily guarantee, however, that Capital Marine is insulated from Levingston's creditors.

9. Based on the foregoing it is recommended that Pennsylvania Shipbuilding Company be considered financially responsible to perform the proposed contract. However, it is recommended that the Contracting Officer closely monitor Penn Ship's progress in the event of an award. Particular attention should be directed towards the future financial performance of Levingston and any future financing arrangements which alter the agreements presently in existence between Penn Ship, Capital Marine and Levingston.

Christopher D. Pigott

Christopher D. Pigott
Procurement Analyst

FINANCIAL CONDITION OF PENN SHIP

STRENGTHS

- POSITIVE WORKING CAPITAL
- CURRENT RATIO OVER 1.0
- AGINGS OF ACCOUNTS RECEIVABLE AND PAYABLE ARE CURRENT
- POSITIVE NET WORTH
- $2.5 MILLION LINE OF CREDIT
- ADDITIONAL OUTSIDE FINANCING OF UP TO $15-20 MILLION LIKELY IF TAO CONTRACT AWARDED
- SALES ON UPWARD TREND
- PROFITABILITY OF CURRENT BACKLOG WORK PROJECTED AT $3.6 MILLION IN 1985

WEAKNESSES

- HIGH DEBT TO WORTH RATIO
- ADDITIONAL OUTSIDE FINANCING NOT GUARANTEED
- LOW PROFITABILITY

FINANCIAL CONDITION OF CAPITAL MARINE

WEAKNESSES

- NEGATIVE WORKING CAPITAL
- NEGATIVE NET WORTH
- LOW PROFITABILITY

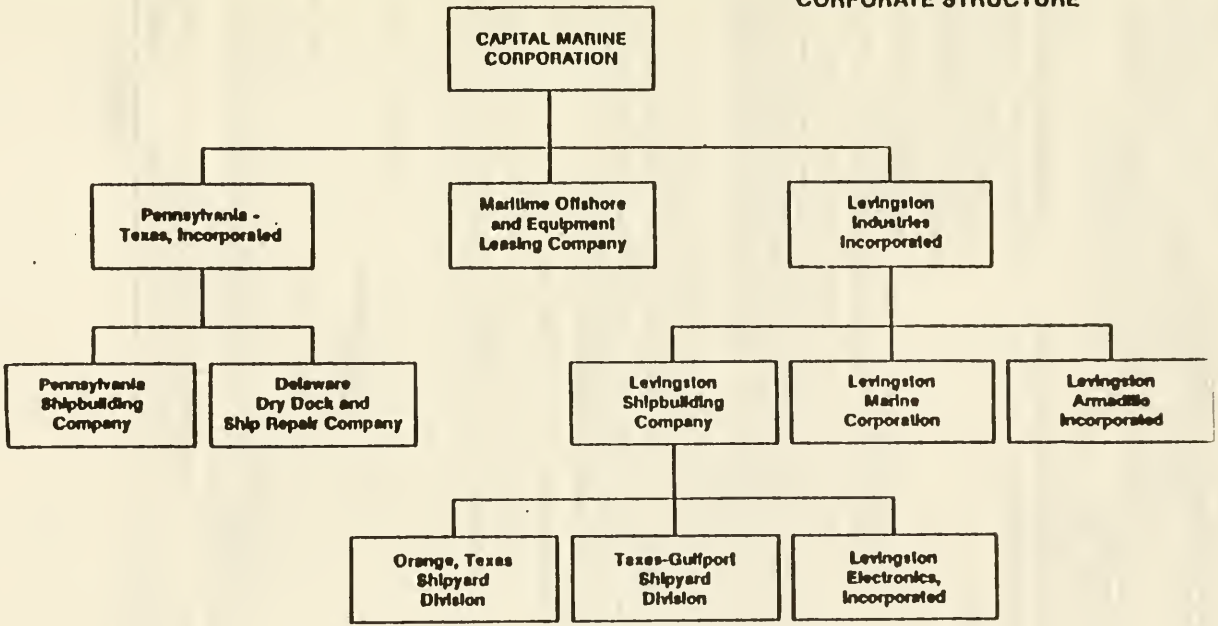
STRENGTHS

- PRIMARY CAUSE OF ABOVE NEGATIVES IS LEVINGSTON
- LEVINGSTON'S PROPERTY ASSETS ARE WORTH MORE THAN ITS OUTSTANDING LIABILITIES
- EXISTENCE OF FINANCIAL INSULATION BETWEEN PENN SHIP AND LEVINGSTON
- EXISTENCE OF FINANCIAL INSULATION BETWEEN CAPITAL MARINE AND LEVINGSTON

RECOMMENDATIONS

- PENN SHIP BE CONSIDERED FINANCIALLY RESPONSIBLE
- MONITOR LEVINGSTON'S FINANCIAL PERFORMANCE
- MONITOR FUTURE FINANCIAL ARRANGEMENTS

CAPITAL MARINE CORPORATION
CORPORATE STRUCTURE



7/25/84

AMENDMENT OF SOLICITATION/MODIFICATION OF CONTRACT

1 CONTRACT ID CODE	PAGE OF PAGES
M	1 | 6

2 AMENDMENT/MODIFICATION NO.	3 EFFECTIVE DATE	4 REQUISITION/PURCHASE REQ. NO.	5 PROJECT NO. (If applicable)
P00017	see BLK 16C	N00024-89-PR-05106	9021205106

6 ISSUED BY — CODE N00024

Department of the Navy
Naval Sea Systems Command
Washington, DC 20362-5101
Buyer/Symbol: D. McLaughlin/02222J
Phone: (202) 692-3102

7 ADMINISTERED BY (If other than Item 6) — CODE N62794

Supervisor of Shipbuilding
Conversion and Repair, USN
Brooklyn, NY 11251-9000

8 NAME AND ADDRESS OF CONTRACTOR (No., street, county, State and ZIP Code)

Pennsylvania Shipbuilding Co.
P.O. Box 442
Foot of Morton Ave.
Chester, PA 19016

(x) 9A. AMENDMENT OF SOLICITATION NO.

9B. DATED (SEE ITEM 11)

10A. MODIFICATION OF CONTRACT/ORDER NO.
N00024-85-C-2115

X 10B. DATED (SEE ITEM 13)
06 May 1985

CODE — FACILITY CODE

11 THIS ITEM ONLY APPLIES TO AMENDMENTS OF SOLICITATIONS

☐ The above numbered solicitation is amended as set forth in Item 14. The hour and date specified for receipt of Offers ☐ is extended, ☐ is not extended.

Offers must acknowledge receipt of this amendment prior to the hour and date specified in the solicitation or as amended, by one of the following methods: (a) By completing Items 8 and 15, and returning _____ copies of the amendment; (b) By acknowledging receipt of this amendment on each copy of the offer submitted; or (c) By separate letter or telegram which includes a reference to the solicitation and amendment numbers. FAILURE OF YOUR ACKNOWLEDGMENT TO BE RECEIVED AT THE PLACE DESIGNATED FOR THE RECEIPT OF OFFERS PRIOR TO THE HOUR AND DATE SPECIFIED MAY RESULT IN REJECTION OF YOUR OFFER. If by virtue of this amendment you desire to change an offer already submitted, such change may be made by telegram or letter, provided each telegram or letter makes reference to the solicitation and this amendment, and is received prior to the opening hour and date specified.

12 ACCOUNTING AND APPROPRIATION DATA (If required)

13 THIS ITEM APPLIES ONLY TO MODIFICATIONS OF CONTRACTS/ORDERS. IT MODIFIES THE CONTRACT/ORDER NO. AS DESCRIBED IN ITEM 14.

(x) A. THIS CHANGE ORDER IS ISSUED PURSUANT TO: (Specify authority) THE CHANGES SET FORTH IN ITEM 14 ARE MADE IN THE CONTRACT ORDER NO. IN ITEM 10A.

B. THE ABOVE NUMBERED CONTRACT/ORDER IS MODIFIED TO REFLECT THE ADMINISTRATIVE CHANGES (such as changes in paying office, appropriation date, etc.) SET FORTH IN ITEM 14, PURSUANT TO THE AUTHORITY OF FAR 43.103(b).

C. THIS SUPPLEMENTAL AGREEMENT IS ENTERED INTO PURSUANT TO AUTHORITY OF:

X Article 63 Default

D. OTHER (Specify type of modification and authority)

E. IMPORTANT: Contractor ☐ is not, ☒ is required to sign this document and return 2 copies to the issuing office.

14 DESCRIPTION OF AMENDMENT/MODIFICATION (Organized by UCF section headings, including solicitation/contract subject matter where feasible.)

See attached.

Senate Permanent Subcommittee on Investigations
EXHIBIT # 21

Except as provided herein, all terms and conditions of the document referenced in Item 9A or 10A, as heretofore changed, remains unchanged and in full force and effect.

15A. NAME AND TITLE OF SIGNER (Type or print)	16A. NAME AND TITLE OF CONTRACTING OFFICER (Type or print)
R. J. STEVENS, PRESIDENT	HAROLD V. WILSON Contracting Officer
15B. CONTRACTOR/OFFEROR (Signature of person authorized to sign)	15C. DATE SIGNED 8/24/89
16B. UNITED STATES OF AMERICA (Signature of Contracting Officer)	16C. DATE SIGNED 28 AUG 89

NSN 7540-01-152-8070
PREVIOUS EDITION UNUSABLE

30-105

STANDARD FORM 30 (REV. 10-83)
Prescribed by GSA

ATTACHMENT A

(1) Pennsylvania Shipbuilding Company (PSC), shall perform the scope of work as described in Exhibit I and will provide the deliverables as set out on Exhibit II. Should the Government require ABS inspection of that part of the work undertaken under contract modifications P00011 through this modification; specifically, the steel fabrication and erection work which PSC understands will be reviewed for acceptability at PSC by the tow underwriter or by a commercial surveyor designated by such underwriter, or designated by the Government, and if by the Government, acceptable to PSC; and inspected for acceptability by ABS at the completion contractor's facility, and at his expense; then the cost of such inspection, including the preparation and any additional work required, and the overhead associated with such work, will be additional to the contract values agreed to for transfer, and a credit should be realized by the Government from the completion contractor, who should have this work included in his price.

(2) PSC will prepare T-AO vessels 191 and 192 for tow in a condition satisfactory to the commercial insurance underwriter or a commercial surveyor designated by such underwriter, or designated by the Government, and if by the Government, acceptable to PSC; and PSC shall perform the other tasks and duties, all as more specifically set out in Exhibit I, entitled

(17) Notwithstanding any other provision of this Modification, the performance period of the schedule for completion of transfer of termination material and equipment (i.e. milestone 8 of Exhibit V) is deemed to have commenced on 15 August 1989. The parties have agreed that the selection of a completion contractor by the Government after 15 August 1989 may adversely affect the completion of transfer of termination inventory by 7 November 1989 (12 weeks after 15 August 1989). For each day for which the contractor may be required by the Government to protect, preserve and maintain the termination inventory beyond 7 November 1989, the Government shall pay the contractor a daily price of $45,000.00 for such effort; however, the obligation for payment addressed in this paragraph shall not be for any more days than the actual number of days beyond 15 August 1989 by which the Government notifies the contractor of the selection of the reprocurement contractor. Any delay in performance of the aforementioned schedule of material transfer by either the completion contractor or the Government beyond those addressed in this paragraph will be separately negotiated between the parties and an equitable adjustment made in the contract price. Said amounts shall be payable upon presentation of a proper invoice, approved by the Contracting Officer, to the Payment Office.

pay the Government 50% of any excess cash flow as of 30 September 1990 or up to $5.09M. Accordingly, PSC agreed to liquidate its assets to maximize this cash flow. PSC also pledged their $19.0M dry dock in lieu of the receipt of sales proceeds.

PSC submitted its cash flow model in accordance with the terms of P00017. This model indicated PSC had negative cash flow and was therefore not required to pay for any reprocurement costs. The Navy did however take title of PSC's floating drydock. In accordance with P00017, Penn Ship was entitled to $1,178,312 that remained unpaid under the contract and can be broken down into four separate payments:

1. Exhibit I of P00017 stated the sum of $2.0M will be paid to Penn Ship to complete the transfer of material to Tampa Ship. 25% of this payment was due upon delivery of T-AO ~~192~~, another 25% upon delivery of T-AO 191, 40% upon completion of the last material shipment, and the remaining balance (10%) due within 30 days following of all other PSC obligations. Invoice No. 5-17 for $200K is payment for the final 10% completion of all other PSC obligations;

2. Exhibit 1 of P00017 also set forth payment for the protection, preservation and maintenance of the terminated inventory to be shipped to Tampa. The Government was required to pay $45,000 for each day of delay in the selection of a contractor to complete the T-AO 191 and 192. The delay covered the period form 07 November 1989 to 13 February 1990 (99 days). The five (5) holidays during this period were counted twice, which brought the total number of days to 104 (104 x $45,000 = $4,680,000). As of 26 February 1991, Penn Ship had invoiced the Government and had been paid $4,230,000 leaving a balance of $450,000 due Penn Ship;

3. During termination for default negotiations held at Penn Ship, NAVSEA agreed to pay Penn Ship $15,000 per week for the protection and preservation services on T-AO 192 in drydock #4 while awaiting delivery to the Government. The T-AO 192 remained in drydock #4 for nine (9) weeks (9 weeks x $15,000 = $135,000). This payment shall be made under P00019; and

4. Under P00005 to the contract, CLIN 0005 was established for labor, material and equipment associated with the transfer of material to Avondale Industries, Inc. for the T-AO 194 and 196 in FY 86. The fixed price of this line item was $10.6M. To date the contractor has been paid $10,206,688 of incurred cost. Since CLIN 0005 was a fixed price line item,

Senate Permanent Subcommittee on Investigations
EXHIBIT # 22

1. AMENDMENT OF SOLICITATION/MODIFICATION OF CONTRACT | 2. CONTRACT CODE | PAGE OF PAGES 1 | 2

3. AMENDMENT/MODIFICATION NO.	4. EFFECTIVE DATE	5. REQUISITION/PURCHASE REQ. NO.	6. PROJECT NO. (If applicable)
P00019	See Blk 16C		

7. ISSUED BY — CODE N00024

Department of the Navy
Naval Sea Systems Command
Washington, DC 20362-5101
Buyer/Symbol: LT. Jeff Miller/02232M
Phone: (703) 602-7517

8. ADMINISTERED BY (If other than Item 6) — CODE N62794

Supervisor of Shipbuilding
Conversion and Repair, USN
Brooklyn, NY 11251-9000

9. NAME AND ADDRESS OF CONTRACTOR (No., street, county, State and ZIP Code)

Pennsylvania Shipbuilding Co.
P.O. Box 442
Foot of Morton Ave.
Chester, PA 19016

JACKET FILE

(X) 10A. AMENDMENT OF SOLICITATION NO.

10B. DATED (SEE ITEM 11)

X 10A. MODIFICATION OF CONTRACT/ORDER NO. N00024-85-C-2115

10B. DATED (SEE ITEM 13) 06 May 1985

CODE | FACILITY CODE

11. THIS ITEM ONLY APPLIES TO AMENDMENTS OF SOLICITATIONS

☐ The above numbered solicitation is amended as set forth in Item 14. The hour and date specified for receipt of Offers ☐ is extended, ☐ is not extended.

Offers must acknowledge receipt of this amendment prior to the hour and date specified in the solicitation or as amended, by one of the following methods: (a) By completing Items 8 and 15, and returning _____ copies of the amendment; (b) By acknowledging receipt of this amendment on each copy of the offer submitted, or (c) By separate letter or telegram which includes a reference to the solicitation and amendment numbers. FAILURE OF YOUR ACKNOWLEDGMENT TO BE RECEIVED AT THE PLACE DESIGNATED FOR THE RECEIPT OF OFFERS PRIOR TO THE HOUR AND DATE SPECIFIED MAY RESULT IN REJECTION OF YOUR OFFER. If by virtue of this amendment you desire to change an offer already submitted, such change may be made by telegram or letter, provided each telegram or letter makes reference to the solicitation and this amendment, and is received prior to the opening hour and date specified.

12. ACCOUNTING AND APPROPRIATION DATA (If required)

See attached Financial Data Sheet

13. THIS ITEM APPLIES ONLY TO MODIFICATIONS OF CONTRACTS/ORDERS, IT MODIFIES THE CONTRACT/ORDER NO. AS DESCRIBED IN ITEM 14.

(X) A. THIS CHANGE ORDER IS ISSUED PURSUANT TO: (Specify authority) THE CHANGES SET FORTH IN ITEM 14 ARE MADE IN THE CONTRACT ORDER NO. IN ITEM 10A.

B. THE ABOVE NUMBERED CONTRACT/ORDER IS MODIFIED TO REFLECT THE ADMINISTRATIVE CHANGES (such as changes in paying office, appropriation date, etc.) SET FORTH IN ITEM 14, PURSUANT TO THE AUTHORITY OF FAR 43.103(b).

C. THIS SUPPLEMENTAL AGREEMENT IS ENTERED INTO PURSUANT TO AUTHORITY OF:

Article 63 Default

D. OTHER (Specify type of modification and authority)

E. IMPORTANT: Contractor [X] is not, ☐ is required to sign this document and return _____ copies to the issuing office.

14. DESCRIPTION OF AMENDMENT/MODIFICATION (Organized by UCF section headings, including solicitation/contract subject matter where feasible.)

See Attached

Permanent Subcommittee on Investigations
EXHIBIT # 23

Except as provided herein, all terms and conditions of the document referenced in Item 9A or 10A, as heretofore changed, remains unchanged and in full force and effect.

15A. NAME AND TITLE OF SIGNER (Type or print)		16A. NAME AND TITLE OF CONTRACTING OFFICER (Type or print)	
		HAROLD V. HANSON Contracting Officer	
15B. CONTRACTOR/OFFEROR	15C. DATE SIGNED	16B. UNITED STATES OF AMERICA	16C. DATE SIGNED
(Signature of person authorized to sign)		BY (Signature of Contracting Officer)	25 SEP 1991

NSN 7540-01-152-8070 — 30-105 — STANDARD FORM 30 (REV. 10-83) Prescribed by GSA

The purpose of this modification is fund services as described in subparagraph (a) below. The following applies:

1. Under Article (1) entitled "General Statement of Work", make the following change:

a. Increase the price of Item No. 0001 from $331,400,000 by $785,000 to $332,185,000. This $785,000 is broken down as follows:

- $200,000 represents the final 10% completion of all PSC obligations as set forth in Exhibit I of P00017 (10% of $2.0M);

- $450,000 represents the remaining balance of the $4,680,000 for services to protect, preserve and maintain the termination inventory. P00017 stipulated the Government would pay $45,000 per day for such effort. A total of 104 days were required (104 x $45,000 = $4,680,000). $4,230,000 has been invoiced to date ($4,680,000 - $4,230,000 = $450,000); and

- $135,000 is for payment for the protection and preservation of the T-AO 192 while laying afloat in drydock #4 awaiting delivery to the Government. The Government was charged $15,000 per week for nine weeks (9 weeks x $15,000 = $135,000).

2. Except as modified herein, all other terms and conditions of the Contract remain unchanged and in full force and effect.

Senate Permanent Subcommittee
on Investigations
EXHIBIT # 24

TRUST INDENTURE
March 26, 1985

TRUSTEE
FIDELITY BANK, NATIONAL ASSOCIATION

COMPANIES
PENNSYLVANIA SHIPBUILDING COMPANY
DELAWARE DRYDOCK & SHIP REPAIR COMPANY
MARITIME AND OFFSHORE EQUIPMENT
LEASING COMPANY

Submitter requests at least ten (10) days prior notice of any USG/DOD intent to disclose pursuant to any FOIA request. Submitter further requests, in that event, opportunity to submit memoranda of reasons for nondisclosure.

BUSINESS CONFIDENTIAL -- FOIA EXEMPT

Submitter requests at least ten (10) days prior notice of any USG/DOD intent to disclose pursuant to any FOIA request. Submitter further requests, in that event, opportunity to submit memoranda of reasons for nondisclosure.

BUSINESS CONFIDENTIAL -- FOIA EXEMPT

TRUST INDENTURE

This Trust Indenture ("Indenture") made this 26th day of March, 1985, by, between and among Pennsylvania Shipbuilding Company, a Pennsylvania corporation ("Penn Ship"), Delaware Drydock & Ship Repair Company, a Pennsylvania corporation ("Delaware"), Maritime and Offshore Equipment Leasing Company, a Texas corporation ("MOEL"), (Penn Ship, Delaware and MOEL sometimes collectively called the "Companies"), and Fidelity Bank, National Association, its successor or successors by merger, conversion, consolidation or otherwise ("Trustee");

W I T N E S S E T H:

WHEREAS, Penn Ship has submitted a proposal ("Proposal") to the United States Navy ("Navy") under Solicitation N00024-84-R-2223(Q) to construct certain T-AO 187 Class Fleet Replenishment Oiler Ships (the "Ships"); and

WHEREAS, if the Proposal is accepted by the Navy, Penn Ship and the Navy shall enter into a contract ("T-AO Contract") for the construction of certain Ships; and

WHEREAS, in connection with the Navy's pre-award survey, Penn Ship has submitted to the Navy information, including information concerning the assets of the Companies, to

demonstrate that Penn Ship has the financial responsibility to satisfy its obligations under the T-AO Contract; and

WHEREAS, in connection with the Navy's pre-award survey, Penn Ship desires to assure the Navy that its obligations under the T-AO Contract will be satisfied by providing to the Trustee mortgages or security interests in certain assets of the Companies; and

WHEREAS, the Companies desire that Penn Ship be awarded the T-AO Contract; and

WHEREAS, the Trustee is willing to serve as Trustee hereunder in accordance with the provisions contained herein;

NOW, THEREFORE, THIS INDENTURE WITNESSETH, that in order to ensure the satisfaction of Penn Ship's obligations under the T-AO Contract, each of the Companies does by separate instruments (collectively called the "Security Instruments") grant to the Trustee a security interest and/or mortgage in the assets described in the respective Security Instruments (the "Asset" or "Assets") subject to the terms and provisions of each of said Security Instruments and to the provisions herein. The Security Instruments are attached hereto as Exhibits A through E, incorporated herein by reference and made a part hereof, and are described as follows:

EXHIBIT A - MORTGAGE FROM PENN SHIP TO TRUSTEE;

EXHIBIT B - MORTGAGE FROM DELAWARE TO TRUSTEE;

EXHIBIT C - SECURITY AGREEMENT FROM PENN SHIP AND DELAWARE TO TRUSTEE;

EXHIBIT D - SECURITY AGREEMENT FROM MOEL TO TRUSTEE;

EXHIBIT E - SHIP MORTGAGE FROM PENN SHIP TO TRUSTEE.

To have and to hold the same unto the Trustee and its successors in interest, IN TRUST, NEVERTHELESS, for the uses and purposes provided for herein.

1. The Security Instruments are given by the Companies to the Trustee to secure any payments (the "Security Payments") that may become due by Penn Ship to the Navy for (i) the net advance or progress payments in excess of progress payments earned for work performed under the T-AO Contract from time to time, and (ii) any amounts that become payable pursuant to Subparagraphs (b) and/or (c) of Article 31 of the T-AO Contract; and which Security Payments are not timely paid by Penn Ship to the Navy within a reasonable time after receipt by Penn Ship of written demand therefor by the Navy. A copy of Article 31 of the T-AO Contract is attached as Exhibit F hereto and made a part hereof. In all events, no Security Payment shall be due or payable until the termination of the T-AO Contract pursuant to Subparagraphs (b) and/or (c) of Article 31. The Companies and the Trustee agree that, for purposes of determining the amount of the Security Payments due under Subparagraphs (b) and/or (c) of Article 31, the excess costs of reprocurement of all or any portion of the T-AO Contract

that has been terminated shall be deemed to be immediately due and payable hereunder and under the Security Instruments as a Security Payment at the time said reprocurement contract is awarded by the Navy.

2. Upon receipt by the Trustee of written notice from the Navy (which shall include a photocopy of the Navy's written notice to Penn Ship of demand for payment) of the total amount of Security Payments due and payable by Penn Ship to the Navy, Trustee shall within 10 days thereafter give notice by sending a copy thereof to each of the Companies, and may proceed, 120 days after the delivery of such notice to the Companies, to exercise any and all rights and remedies available to the Trustee under any one or more of the Security Instruments, including, without limitation the powers of non-judicial sales, collecting the proceeds from any such actions and remitting, after deducting all expenses of same with respect to each such action, the net proceeds to the Navy to the extent due, but not in excess of the Maximum Navy Amount set forth in Section 3 below. The Trustee shall inform the Navy prior to exercising any such rights or remedies, and shall not be required to take any action before receiving prior Navy approval of same. During said 120-day period the Companies shall use their best efforts to make the Security Payments to the Navy and may sell all or part of the

Assets provided the net proceeds are paid to the Trustee. The Trustee shall accept any sales of such Assets which are approved by the Navy in writing and release the same from the applicable Security Instrument upon receipt of the net proceeds from sale thereof, and shall promptly remit the said proceeds to the Navy.

3. Notwithstanding anything to the contrary contained herein or in any of the Security Instruments, the maximum amount ("Maximum Navy Amount") payable to the Navy hereunder shall be the lesser of (i) the total amount of the Security Payments payable by Penn Ship to the Navy or (ii) Twenty Million Dollars ($20,000,000). Any excess of proceeds from actions pursuant to the Security Instruments then shall be paid by the Trustee to Penn Ship. The Companies agree to the extent allowable by law that the rights and remedies given hereunder in favor of the Trustee for the benefit of the Navy shall survive and be binding upon the Companies notwithstanding any bankruptcy proceedings filed by or against any one or more of the Companies.

4. The Companies shall pay the Trustee an annual fee for serving as Trustee hereunder in the amount of Two Thousand Five Hundred Dollars ($2,500), payable on the effective date hereof and the same date each year thereafter during the existence of this Trust Indenture.

5. In the event of any dispute between the Companies and the Navy as to any of the terms hereof, or as to who is entitled to the funds from foreclosure of the Security Instruments, or any part thereof, Trustee may, at its election, pay such funds into any court having jurisdiction in the premises, paying all lawful charges in connection therewith from the funds.

6. This Indenture may be altered or amended only with the written consent of the parties hereto and the Navy, as represented by the Procuring Contracting Officer for the T-AO Contract. Should any party seek to change this Indenture in any manner that would increase the Trustee's duties or responsibilities or which the Trustee deems prejudicial to its interest, or should Trustee desire to resign because of a conflict of interest or any other reasonable cause, Trustee may resign immediately by notifying the other parties by certified mail to the addresses specified in this Indenture, and, until a successor to Trustee is appointed and accepts such appointment, Trustee's only duty shall be to hold the Security Instruments (or funds collected upon actions pursuant thereto) intact.

7. The Security Instruments granted hereby to the Trustee are subordinate and inferior to existing first liens against the Assets, which first liens do not exceed as of date hereof the aggregate total amount of $18,000,000. Notwithstanding anything to the contrary contained herein or in the Security Instruments,

each of the Companies shall have the right, at its sole option at any time or times, to grant to any one or more persons, firms, corporations or entities (the "Substituted First Lienholder") a mortgage or security interest and first lien in and to all or part of the Assets which shall constitute a prior lien on such Assets and which will constitute a prior mortgage or security interest and lien therein of the Trustee, but only to the aggregate extent of Twenty-Four Million Dollars ($24,000,000) for all Assets ("Maximum Refinance Amount"), and only upon cancellation of the prior lien or liens then maintained by the first lienholder with respect to such Assets. Upon the cancellation of the said prior first lien and the granting of such new first mortgage or security interest and lien in such Assets to the Substituted First Lienholder, the applicable Security Instrument with respect to such Asset or Assets and the lien thereunder shall automatically thereupon be and become subordinate to the lien of said Substituted First Lienholder, up to the amount set forth therein not to exceed in the aggregate the Maximum Refinance Amount. The Companies shall have the right in their discretion to allocate said Maximum Refinance Amount among the Assets as they see fit. The Trustee agrees, at the Companies' expense, to promptly execute and file such instruments and documents as may be necessary or appropriate in order to evidence such subordination up to the amount of the substituted

first lien not to exceed in the aggregate the Maximum Refinance Amount.

8. The Trustee shall not be bound in any way by any other agreement or contract between Penn Ship and the Navy, and Trustee's only duties will be to hold, administer and deal with the Security Instruments (or funds collected upon actions pursuant thereto) in accordance with the terms of this Indenture.

9. The parties hereto have satisfied themselves as to the identity and authority of all persons signing this Indenture and any documents required hereunder and have also satisfied themselves as to the representative capacity in which said persons are acting. Should it be necessary for the Trustee to accept or act upon any instructions, directions, documents or instruments signed or issued by or on behalf of any corporation, partnership, trade name, fiduciary or individual, it shall not be necessary for the Trustee to inquire into such person's authority except as otherwise specified herein, and Trustee shall be fully protected in so accepting or so acting upon any such instructions, directions, documents or instruments.

10. The Trustee shall not be liable to any of the parties hereto for any damages resulting to them arising out of its good faith acts or omissions in the carrying out of any of its duties or responsibilities hereunder. The Trustee reserves the right, but shall in no way be obligated, to call upon the parties

hereto, or any of them, for written instructions before taking any action hereunder, other than actions which specifically call for written notice. Any action taken by the Trustee or omitted to be taken, or suffered in good faith in accordance with the written advice of its attorneys shall be conclusively presumed to meet the above requirements exempting the Trustee from any liability hereunder except by reason of its gross negligence or willful misconduct.

11. Trustee shall not be required to institute or defend any action or legal process involving any matter referred to herein which in any manner affects it or its duties or liabilities hereunder unless or until requested to do so by the Companies (except for the exercise of any rights or remedies under the Security Instruments as provided in Paragraph 2 of this Indenture) and then only upon receiving full indemnity, in an amount and of such character as it shall require, against any and all claims, liabilities, judgments, attorneys' fees and other expenses of every kind in relation thereto, except in the case of its own willful misconduct or gross negligence.

12. This Indenture shall be binding upon and inure to the benefit of the parties hereto, their successors and assigns. and shall be governed as to its validity, interpretation and effect by the laws of the Commonwealth of Pennsylvania. Nothing contained herein or in the Security Instruments shall affect any

and all other rights or remedies available to the Navy under the T-AO Contract.

13. The address of each party hereto for purposes of written notices shall be as follows:

Pennsylvania Shipbuilding Company
Foot of Morton Avenue
Chester, PA 19031

Attention: Mr. William Jarrett

Delaware Drydock & Ship Repair
Foot of Morton Avenue
Chester, PA 19031

Attention: Mr. William Jarrett

Maritime and Offshore Equipment
Leasing Company
P.O. Box 442
Chester, PA 19031

Attention: Mr. William Jarrett

Fidelity Bank, National Association
Broad & Walnut Streets
Philadelphia, PA 19109

Attention: Corporate Trust Administration

All notices required hereunder shall be given in writing by personal delivery thereof or by certified mail, return receipt requested. Whenever herein any action or approval is contemplated to be performed by the Navy the same shall be effectuated by the Procuring Contracting Officer of the Navy for the T-AO Contract, unless the Navy designates otherwise in writing to the Companies and the Trustee.

14. This Indenture and the Security Instruments shall become effective and binding upon the written execution of a T-AO Contract by Penn Ship and the Navy which provides for the construction of a minimum of two Ships for fiscal year 1985 and an option for the construction of a minimum of one or more Ships during fiscal years 1986 and/or 1987. The Companies shall promptly give written notice to the Trustee of such award when and if received and shall promptly file all mortgages, financing statements and other documents necessary to perfect the Trustee's secured status under the Security Instruments promptly following this Indenture becoming effective and binding as provided herein. Trustee is entitled, at any time and at the Companies' expense, to seek the advice of counsel on the actions necessary or advisable to perfect Trustee's secured status under the Security Instruments or to maintain its perfected status.

15. This Indenture shall terminate and become null and void at such time as the Trustee receives written notice from Penn Ship and the Navy stating that the T-AO Contract has been completed in full. Upon receipt of such written notice the Trustee shall promptly execute appropriate instruments cancelling the Security Instruments and the liens upon the Assets.

16. Trustee hereby accepts the Trust hereunder in accordance with the terms of this Indenture.

In Witness Whereof, the parties have hereunto executed this Agreement on the date and year first above written.

PENNSYLVANIA SHIPBUILDING COMPANY

ATTEST:

By: _____
As Its Ass't Secretary

By: _____
As Its Chairman of the Board

DELWARE DRYDOCK & SHIP REPAIR COMPANY

ATTEST:

By: _____
As Its Ass't Secretary

By: _____
As Its Chairman of the Board

MARITIME AND OFFSHORE EQUIPMENT LEASING COMPANY

ATTEST:

By: _____
As Its Ass't Secretary

By: _____
As Its President

FIDELITY BANK, NATIONAL ASSOCIATION

ATTEST:

By: Stephen B. Mezzetti
As Its Asst. Secretary

By: _____
As Its Senior Corporate Trust Officer

DISTRICT OF COLUMBIA : ss

On this 25th day of March A.D. 1985, before me T.C. Weller, Jr., the undersigned officer, personally appeared Chairman of the Board, who acknowledged himself to be the President of Pennsylvania Shipbuilding Company, a Pennsylvania corporation, and that he as such corporate officer, being authorized to do so, executed the foregoing instrument for the purposes therein contained by signing the name of the corporation by himself as President.

IN WITNESS WHEREOF, I hereunto set my hand and official seal.

Notary Public, District of Columbia
My Commission Expires: _____

DISTRICT OF COLUMBIA : ss

On this 25th day of March A.D. 1985, before me T.C. Weller, Jr., the undersigned officer, personally appeared Chairman of the Board, who acknowledged himself to be the President of Delaware Drydock & Ship Repair Company, a Pennsylvania corporation, and that he as such corporate officer, being authorized to do so, executed the foregoing instrument for the purposes therein contained by signing the name of the corporation by himself as President.

IN WITNESS WHEREOF, I hereunto set my hand and official seal.

Notary Public, District of Columbia

My Commission Expires: _____

My Commission Expires January 1, 1986

DISTRICT OF COLUMBIA : ss

On this 21st day of March A.D. 1985, before me T.C. Weller, Jr., the undersigned notary public, personally appeared President, who acknowledged himself to be the President of Maritime and Offshore Equipment Leasing Company, a Texas corporation, and that he as such corporate officer, being authorized to do so, executed the foregoing instrument for the purposes therein contained by signing the name of the corporation by himself as President.

IN WITNESS WHEREOF, I hereunto set my hand and official seal.

Notary Public, District of Columbia
My Commission Expires: _____

My Commission Expires January 1, 1986

COMMONWEALTH OF PENNSYLVANIA:
COUNTY OF PHILADELPHIA : ss

On this 26th day of March A.D. 1985, before me the undersigned notary public, personally appeared Terence C. McPoyle, who acknowledged himself to be the Senior Corporate Trust Officer of Fidelity Bank, National Association, a national banking association; and that he as such senior corpoate trust officer, being authorized to do so, executed the foregoing instrument for the purposes therein contained by signing the name of the national banking association by himself as such officer.

IN WITNESS WHEREOF, I hereunto set my hand and official seal.

LISA OCCHIOLINI
Notary Public, Phila., Phila. Co.
My Commission Expires Feb. 13, 1989

Lisa Occhiolini
Notary Public

88-337

DEPARTMENT OF THE NAVY
NAVAL SEA SYSTEMS COMMAND
WASHINGTON DC 20362-5101

IN REPLY REFER TO

Senate Permanent Subcommittee on Investigations

EXHIBIT # 28

January 28, 1989

Office of Judicial Support
Media Court House
Front Street
Media, PA 19063

Dear Madam or Sir:

Please find enclosed for filing one Uniform Commercial Code Form UCC-1 and attached Security Agreement, granting to the United States of America, Department of the Navy, a security interest in collateral described as "Floating Drydock No. 4," by the debtor Pennsylvania Shipbuilding Company.

Also enclosed is a cashier's check, number 6496098, in the amount of $27, in payment of the costs of filing the Form UCC-1 and attached security agreement.

Please send evidence of filing to the undersigned. A self-addressed, stamped envelope is enclosed for your convenience.

If there are any problems that require resolution, I may be reached at (202) 692-1776. Thank you for your assistance.

Sincerely,

Keith M. Dunn
Assistant Counsel
Naval Sea Systems Command

Enclosures

PARTIES

Debtor name (last name first if individual) and mailing address:

Pennsylvania Shipbuilding Company
Foot of Morton Avenue
Chester, Pennsylvania 19013

1

Debtor name (last name first if individual) and mailing address:

1a

Debtor name (last name first if individual) and mailing address:

1b

Secured Party(ies) of Record name(s) (last name first if individual) and address for security interest information:

United States of America
Department of the Navy
Naval Sea Systems Command
Washington, DC 20362-5101

2

Special Types of Parties (check if applicable):

☐ The terms "Debtor" and "Secured Party" mean "Lessee" and "Lessor," respectively.

☐ The terms "Debtor" and "Secured Party" mean "Consignee" and "Consignor," respectively.

☐ Debtor is a Transmitting Utility.

3

SIGNATURE(S)

Debtor Signature(s) (only if Amendment):

Secured Party Signature(s):

4

FINANCING STATEMENT CHANGE
Uniform Commercial Code Form UCC-3
IMPORTANT — Please read instructions on reverse side of page 4 before completing

Filing No. (stamped by filing officer):

Date, Time, Filing Office (stamped by filing officer):

AUG 29 1 02 PM '89

OFFICE OF
JUDICIAL SUPPORT
DELAWARE CO. PA.

5

This Financing Statement Change is presented for filing pursuant to the Uniform Commercial Code, and is to be filed with the (check applicable box):

☐ Secretary of the Commonwealth.
☒ Prothonotary of Delaware County.
☐ Real Estate Records of _____ County.

6

Number of Additional Sheets (if any): 4 7

Optional Special Identification (Max. 10 characters): 8

ORIGINAL FINANCING STATEMENT BEING CHANGED

This Financing Statement Change relates to an original Financing Statement No. 89-337 filed with the:

☐ Secretary of the Commonwealth on (date) _____
☒ Prothonotary of Delaware County on (date) January 30, 19(
☐ Real Estate Records of _____ County on (date) _____

9

DESCRIPTION OF FINANCING STATEMENT CHANGE

☐ Continuation – The original Financing Statement identified above is still effective.

☐ Termination – The Secured Party of Record no longer claims a security interest under the original Financing Statement identified above.

☐ Release – The Secured Party of Record has released the collateral described in block 11 from the collateral recovered by the original Financing Statement identified above.

☐ Assignment – The Secured Party of Record has assigned to the Assignee, whose name and address are contained in block 11, rights in the collateral described in block 11 under the original Financing Statement indentified above.

☒ Amendment – The original Financing Statement identified above is amended as set forth in block 11 (signatures of Debtor and Secured Party of Record are required).

10

Description of collateral released, rights assigned, Assignee (name and address), or amendment (as indicated in block 10):

To amend Section 1 of the Security Agreement entered into between Debtor and Secured Party on January 26, 1989, to more specifically define the secured obligation and to modify other terms of the Security Agreement as stated in Amendment 1 to Security Agreement, dated August 24, 1989, and attached hereto.

11

RETURN RECEIPT TO:

Keith M. Dunn, Esq.
Office of Counsel (Code OCL)
Naval Sea Systems Command
Washington, DC 20362-5101

12

STANDARD FORM UCC-3
Approved by Secretary of Commonwealth of Pennsylvania

Printed by Julius Blumberg, Inc., NYC 10013

FILING OFFICE ORIGINAL
NOTE — This page will not be returned by the Department of State.

EXHIBIT IX
AMENDMENT NO. 1 TO SECURITY AGREEMENT

THIS AMENDMENT NO. 1 is made and entered into as of this 24th day of August, 1989, by and between PENNSYLVANIA SHIPBUILDING COMPANY, a Pennsylvania corporation (the "Company") and the UNITED STATES OF AMERICA, DEPARTMENT OF THE NAVY (the "Navy").

W I T N E S S E T H :

WHEREAS, pursuant to Contract No. N00024-85-C-2115, as amended to the date hereof, the Company is constructing two fleet oilers for the Navy (the "Contract"); and

WHEREAS, the Navy has made payments to the Company in advance of those earned by the Company under the Contract, and because it appears that the Navy has made overpayments under the Contract, the Navy has required the Company to enter into a Security Agreement dated as of January 26, 1989 (the "Security Agreement") to secure repayment of such advance payments and overpayments if and to the extent not earned by the Company under the terms of the Contract; and

WHEREAS, on the date hereof the parties will enter into a modification of the Contract, a copy of which is attached hereto as Attachment A (hereinafter the "Modification"), wherein, among other things, the obligations of the Company that are secured by the Security Agreement are being incorporated and more specifically defined, and the Company shall be obligated to the Navy for certain reprocurement costs and other liabilities; and

WHEREAS, to secure the obligations of the Company under paragraphs (3) and (4) of Attachment A of the Modification which shall not exceed $19,000,000 (the "Obligations"), the parties hereto have agreed to execute and deliver this Amendment No. 1 to the Security Agreement;

NOW THEREFORE, in consideration of the premises and for other good and valuable consideration, the receipt and adequacy of which are hereby acknowledged, the parties hereto, intending to be legally bound, hereby amend the Security Agreement as follows:

1. Section 1 of the Security Agreement is hereby deleted in its entirety and replaced with the following provision reading in its entirety as follows:

> This Agreement is made to secure the obligations of the Company under paragraphs (3) and (4) of Attachment A of the Modification which shall not exceed $19,000,000 (the "Obligations").

2. Section 3(b) of the Security Agreement is hereby deleted and replaced with the following paragraph:

(b) The Company may sell the Collateral without the prior written consent of the Navy. The Company shall notify the Navy in writing of any bona fide offer to purchase the Drydock, and the Navy shall have 10 days in which to exercise its option to take title to the Drydock prior to the acceptance by the Company of such bona fide offer. The Company shall not remove the Collateral from the Commonwealth of Pennsylvania unless prior written notice is given to the Navy.

3. Section 3(e) of the Security Agreement is hereby amended in its entirety to read as follows:

(e) Floating Drydock No. 4 is free and clear of any and all liens, claims, encumbrances, and security interests except for the security interest granted to the Navy pursuant to the Security Agreement dated as of January 26, 1989, as the same may be modified or amended. The Company shall defend the Collateral against claims and demands made by all persons claiming either the Collateral or any interest in it.

4. The last sentence of Section 3(f) of the Security Agreement is hereby amended to read in its entirety as follows:

"The Navy may upon notice to the Company enter upon the Company's property and inspect the Collateral at any reasonable time."

5. Section 3(g) of the Security Agreement is hereby deleted in its entirety and replaced with a new Section 3(g) reading in its entirety as follows:

(g) The Company shall keep the Collateral continuously insured under an "All Risk" Policy in a total amount not less than $19,000,000. The Company shall also carry other insurance such as comprehensive (broad form) liability-insurance (including bodily injury and property damage, products/completed operations, contractual liability), and full form Hull and Protection & Indemnity Insurance if applicable, in such reasonable amounts as may be determined by the Company. Each policy shall be endorsed with a standard mortgagee or security interest clause for the benefit of the Navy. The Company shall provide the Navy with a certificate annually evidencing compliance with these insurance requirements.

6. Section 3(h) of the Security Agreement is hereby deleted in its entirety.

7. Section 4(a) of the Security Agreement is hereby deleted in its entirety and replaced with a new Section 4(a) reading in its entirety as follows:

(a) The failure by the Company to perform its obligations as set forth in paragraphs (3) and (4) of the Modification.

8. Section 4(c) of the Security Agreement is hereby amended by adding after the word "sale" the phrase "without providing the Navy the right of first refusal".

9. The first paragraph after Section 4(e) is hereby amended by (i) replacing the words "secured obligations" with the word "Obligations", and (ii) by adding the following sentence at the end of said paragraph:

"In the event of sale, any remainder of the proceeds after satisfaction in full of the Obligations shall be distributed to the Company or as otherwise required by applicable law."

10. Section 4 of the Security Agreement is hereby further amended by deleting therefrom the last two paragraphs in their entirety.

11. Section 5 of the Security Agreement is hereby amended to read in its entirety as follows:

5. Option. At anytime following the launch of T-AO 192 while the Navy holds a security interest in the Drydock, the Navy may elect to take title to the Drydock, and such act shall serve to liquidate the Obligations of the Company under the Modification.

12. The Security Agreement is hereby amended by adding thereto a new Section 9 reading in its entirety as follows:

9. Maximum Liability. The parties hereto agree that the Collateral has a current agreed-to value of $19,000,000, and that the maximum liability of the Company under the Security Agreement as amended shall not exceed $19,000,000.

13. The Security Agreement is hereby amended by adding thereto a new Section 10 reading in its entirety as follows:

10. Conflict. In the event of any conflict or ambiguity between the provisions of the Security Agreement, as amended, and the Modification, the provisions of the Modification shall govern and control.

14. Except as modified and expressly amended by this Amendment No. 1, the Security Agreement is in all respects ratified and confirmed, and all the terms, provisions and conditions thereof shall be and remain in full force and effect.

IN WITNESS WHEREOF, the parties have caused this Amendment No. 1 to be duly executed and delivered as of the date first written above.

PENNSYLVANIA SHIPBUILDING COMPANY

By: _____
President

UNITED STATES OF AMERICA,
DEPARTMENT OF THE NAVY,
Naval Sea Systems Command

By: _____
Title: HAROLD V. HANSON
Contracting Officer

Senate Permanent Subcommittee on Investigations
EXHIBIT # 29

(Official number) (1) .....
Barge (2) 800
(Kind) (Former home port)
(1) SUN 800 (Name of vessel)

This vessel was built at Galveston, Texas in 1972 of Steel
by Kelso Marine, Inc. for Sun Shipbuilding & Dry Dock Company
as appears by Certificate of Louis H. Runge, Vice President of Kelso Marine, Inc., BUILDER

GRANTOR	GRANTEE	Kind of instrument and part conveyed	Date of instrument and date of maturity	Consideration or amount and discharge amount	Received for record	Recorded	Time of endorsement and entry or approval of home port	Port where endorsed
Sun Shipbuilding and Dry Dock Company	663 Leasing Company	Undocumented Bill of Sale	1/14/74	$1.00 &OVC	May 14, 1974	Book 14		
		All			8:30 A.M.	Page 118	5/14/74	
					I certify that the foregoing, which is issued in accordance with the provisions of Section 87.67-27(a), Coast Guard Regulations, incident to a change in homeport, is a true Abstract of Title of the vessel described above, as appears by the records of this office.			
					Port: Wilmington, DE			
					Date: 5 FEB 1982			
		RECORD AT PHILADELPHIA, PA.			By direction of the OCMI Philadelphia			
Documentation Officer US Coast Guard Wilmington, De	Documentation Officer US Coast Guard Philadelphia, PA	A/T	2-5-82	NC	8 February 1982	Book 9		
		Whole			2:00 p.m.	Page 257		
663 Leasing Company	Sun Ship, Inc.	8/S	2-5-82	$1.00 & ovc	8 February 1982	Book 79		
		Whole			2:05 p.m.	Page 117		
Sun Ship, Inc.	Pennsylvania Shipbuilding Company	8/S	2-8-82	$1,000,000.00	8 February 1982	Book 79		
		Whole			2:10 p.m.	Page 118	8 February 1982	
Pennsylvania Shipbuilding Company	Sun Ship, Inc.	1st Pref. Mortgage	2-8-82	$8,000,000.00 & POMC	8 February 1982	Book 39	8 February 1982 2:25 p.m.	PHILADELPHIA, PA.
		Whole	11-1-87	Same as total amount	2:20 p.m.	Page 116	8 February 1982 2:27 p.m.	
Sun Ship, Inc.	Pennsylvania Shipbuilding Company	S/M	18 DEC 86	$8,000,000.	15 JAN 87	Book 871	15 JAN 87	PNIVO
		Whole			10:22 a.m.	Page 189		
Pennsylvania Shipbuilding Company	Fidelity Bank, National Association	P/M	19 DEC 86	$3,000,000. & I & POMC	15 JAN 87	Book 871	15 JAN 87 10:30 a.m.	
		Whole	On demand	Aep. prop. (if any).01%	10:25 a.m.	Page 190	15 JAN 87 10:32 a.m.	PNIVO
FINDELITY BANK, NATIONAL ASSOCIATION	PENNSYLVANIA SHIP-BUILDING COMPANY	SAT P/M	03APR89	$5,000,000	18 APRIL 89	BK 894	FILED17APR89	
		ALL			11:40AM	PG 142	7:52AM	
					I certify that the foregoing which is issued in accordance with 46 CFR 67.41 is a true Abstract of Title of the vessel described above, as appears by the records of this office.			

Documentation Officer
Philadelphia, PA Date 2-2-87

GPO 946 712

DEPARTMENT OF TRANSPORTATION
U.S. COAST GUARD
CG-1332 (Rev. 5-82)

OMB APPROVED 2115-0110

GENERAL INDEX OR ABSTRACT OF TITLE

CONTINUATION SHEET NO. 1

554164 (Official number)
(Flag)
(Former home port)

(4) _____
(3) CHESAPEAKE 1000
(2) 800
(1) SUN 800 (Name of vessel)

This vessel was built at _____ in _____ of _____
by _____ for _____
as appears by _____

GRANTOR	GRANTEE	Kind of instrument and part conveyed	Date of instrument and date of maturity	Consideration or amount and discharge amount	Received for record	Recorded	Time of endorsement and entry or approval of home port	Port where endorsed
RECORD AT NEW ORLEANS, LA.								
Pennsylvania Shipbuilding Company	Maritime Capital Corporation	B/S All	2/5/91	------	2/7/91 3:15 P.M.	BS-109 Inst. 433	Filed at 3:09PM 2/5/91	
Maritime Capital Corporation	Gonjon Marine Co., Inc.	Bill of Sale Whole	25 JUL 1991		05 AUGUST 1991 AT 2:30 P. M.	Book 495T Page 129	Filed at New York, N. Y. 05 August 1991 at 10:34 A.M.	
Gonjon Marine Co., Inc.	First Fidelity Bank, National Association, New Jersey	First Preferred Fleet Mrtge. Whole and 12 others	08 NOV 1991	$4,834,000.00 & INT & FOMC	03 JANUARY 1992 AT 10:20 A. M.	Book PM 560 Page 185	Filed at New York, NY on 31 December 1991 at 10:26 AM	

I certify that the foregoing, which is issued in accordance with 46 CFR 67.41-1 is a true abstract of title of the vessel described above, as appears by the records of this office.

_____
Documentation Officer

Port NEW ORLEANS, LA. Date JUL 25 1991

05 AUGUST 1991
(DATE)
RECORD AT NEW YORK, N.Y.

I certify the foregoing, which is issued in accordance with 46 CFR 67.41-3, is a true Abstract of Title of the vessel described above, as appears by the records of this office. This copy is not provided for record.

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DOCUMENTATION OFFICER

Port N.Y. New York, N.Y.
Date NOV 17 1992

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Senate Permanent Subcommittee on Investigations
EXHIBIT # 31

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TCB

UNITED STATES SENATE

COMMITTEE ON GOVERNMENTAL AFFAIRS

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

- - - - - - - - - - - - - - - - - -x
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In the Matter of: :
:
NAVY TAO-187 KAISER CLASS :
OILER SHIP CONTRACT :
:
- - - - - - - - - - - - - - - - - -x

Washington, D.C.

Friday, May 26, 1995

The deposition of GEORGE STEINBRENNER, called for examination by counsel for the United States Senate, Committee on Governmental Affairs, Permanent Subcommittee on Investigations, at Room SR-100, Russell Senate Office Building, Washington D.C., commenced at 12:35 p.m., before Thomas C. Bitsko, a Notary Public in and for the District of Columbia, when were present on behalf of the parties:

APPEARANCES:

On Behalf of the United States Senate, Committee on Governmental Affairs, Permanent Subcommittee on Investigations:

HAROLD DAMELIN, ESQ.
Republican Staff Director and Chief Counsel

On Behalf of the Witness:

BOB BANKER, ESQ.
ARNIE BURNS, ESQ.

ALSO PRESENT:

CHRISTOPHER GREER
Investigator

ERIC THORSON

STEPHEN H. LEVIN
Counsel

SCOTT E. NEWTON
Investigator

LINDA GUSTITUS
Democratic Staff Director/Chief Counsel

- - -

C O N T E N T S

WITNESS	EXAMINATION BY COUNSEL FOR: SUBCOMMITTEE
George Steinbrenner	3

EXHIBITS

STEINBRENNER DEPOSITION EXHIBITS	MARKED
No. 1	19

- - -

P R O C E E D I N G S

Whereupon,

GEORGE STEINBRENNER

was called as the witness and, after being first duly sworn, was examined and testified as follows:

EXAMINATION BY COUNSEL FOR THE U.S. SENATE PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

BY MR. DAMELIN:

Q In 1989, when Tampa Shipyards bid on the Navy contract to complete the two TAO-187 oiler ships, what position did you have with Tampa Shipyards, Inc.?

A I was probably at that time chairman and maybe acting president. I had so many positions during that period of 10 years that it is difficult for me to remember exactly. But to the best of my knowledge, that's what it was.

Q And what was your position with American Shipbuilding at the time--

A I'm sorry--

Q --the bid was submitted?

A I was that with American Shipbuilding.

Q What was that again, please?

A I was, I believe, chairman and acting president at American Ship, I believe, but not at Tampa Ship, no.

Q Did you have any position at Tampa Ship at the

time the bid was submitted?

A I believe I was a member of the board of directors.

Q And at the time the bid was submitted, could you please explain what the relationship was between American Shipbuilding Company and Tampa Shipyards, Inc.?

A American Shipbuilding Company was the mother corporation. Tampa Ship was a wholly owned subsidiary of American Shipbuilding Company.

Q And throughout the period of the TAO contract--that is starting in 1989 up through the period of time that the settlement was just reached--

A Yes.

Q --this year--what was your ownership interest in American Shipbuilding Company?

A Approximately 10 percent.

Q Is that 10 percent of the outstanding shares in that company?

A Yes.

Q Were you the largest or are you the largest individual shareholder of American Shipbuilding Company?

A Yes, I believe I am.

Q In November 1989, Tampa Shipyards was awarded the TAO contract by the Navy. They were awarded this contract despite the fact that Tampa Shipyards was not the low bidder

on that contract. What justification was given by the Navy for awarding the contract to Tampa Shipyards?

A I believe at the time--and I say that because I was not--I was at the corporate level and not at the everyday operational level of Tampa Ship. I believe at the time they expressed several reasons for giving us the contract. At the time we received the contract, I believe there were objections by another shipyard that we were not the lowest bid, that they were. And I believe that that was Avondale, and as I understood, they filed an objection, and that the Navy determined that they would give it to us. I think the objection filed ultimately turned out to be a little phoney anyway, because they had been awarded two ships and they weren't the lowest bidder. Avondale I am speaking of.

I believe that the reasons were as follows: At that particular period, there was a desire to go into this fast deployment shipbuilding program. The Navy made a determination at the time that there were not enough sources to--they didn't want to get into a situation where it was sole-source procurement, which would have been--might very well have been the case. Because as I recall, the west coast shipyard, NASCO, was involved, but they were having problems, I believe, with the AOEs or whatever thing they were involved with.

The shipyard at Avondale had had some rather large overruns, I believe, on their ships. Bethlehem and ourselves and maybe one other company--I can't recall it--felt that they would all like to be a part of it, except that one or two of those shipyards had said possibly they would be leaving the business. I know Bethlehem said they wanted to probably get out of new construction and, if they stayed in, concentrate on repair.

There were just not a multitude of shipyards available. A lot of shipyards had dropped out of business. I think at one point more than 40 in a 5-year period, small and large, had gone out of business.

The industry was a particularly difficult industry, and I think that the Navy felt that they didn't want to be left with a sole source of procurement for any ship, which in my opinion was good, sound reasoning. And they knew at that time things in the world--the world changed during that period from day to day almost, and the Navy felt that they wanted to have more than one source. That to me is what I understood at the time it happened.

Q Well, do you remember that part of the justification for the award was under the justification for industrial base necessity?

A I remember that, yes.

Q Now, the contract was awarded to you in November

1989.

A All right, sir.

Q In a December 13, 1988, letter written by then-Navy Secretary Ball to Congress, the Navy indicated that Tampa Shipyards was non-essential to the U.S. industrial base, yet less than a year later, in November 1989, the Navy awarded this contract to Tampa Shipyards under an industrial base necessity justification.

My question is: What action did you personally or Tampa Shipyards or American Shipbuilding take in an effort to obtain the industrial base justification?

A I was involved in some meetings on that, but not at all levels. When we found out that certain shipyards were talking about possibly even going out of business. Jacksonville, which is a big shipyard, which was owned by, I believe, Fruehauf at the time in Jacksonville, Florida, were talking about whether they would continue in business. When several of these other companies said that they may get out and when our company made the determination to seek more contracts with the Navy, because we had had quite a bit of success with the T-5 tankers, I think Mr. Anselmi felt that we should go after this because this--whether you call it endorsement or whatever--because it was a good opportunity for us and maybe time that we were a part of that base. There just was not a lot of commercial work. So in a

meeting, we discussed this, and I said fine.

Q What actions, Mr. Steinbrenner, did you take? Did you contact anybody in an effort to have Tampa Shipyards classified as an industrial base necessity?

A We had contacts through our people in Washington who represented us as to how you go about qualifying for that.

Q Who was that that you communicated with?

A Well, we had been represented in Washington by Bill Ragan of Ragan and Mason, who was a very knowledgeable man in some of these areas, and as I recall, meetings were held with him by our people as to how to go about securing such a qualification.

Q Did you participate in those meetings?

A I don't believe I did in his offices participate in that meeting. I participated in many meetings with Bill Ragan because he was a friend of many years.

Q I'm going to get into that a little bit later.

A Okay.

Q I'm talking about in connection with the Navy oiler contract and what you did to help try to get Tampa classified as a necessary industrial base?

A I don't believe that when they made the plan as to how they would--what ships they were interested in and what programs they were interested in, I don't believe I was a

part of that. To the best of my knowledge, I was not.

Q In connection with that effort, did you meet or speak with anybody from the Navy?

A I don't believe--to the best of my knowledge, I didn't, no. I don't recall. That was quite a few years ago.

MR. BANKER: This is 1989.

THE WITNESS: Yes.

BY MR. DAMELIN:

Q Did you speak with anybody that was a Member of Congress at the time?

A I spoke with several Members of Congress from time to time concerning American Ship.

Q Let's focus on--

A Just that one thing at that time?

Q At this stage. I'm going to take you through a series of different stages.

A All right.

Q You have submitted your bid, and you're trying to get the contract to complete the two ships. You end up getting awarded the contract on an industrial base necessity justification. Did you talk to anybody in Congress, make contact with anybody in Congress in connection with that?

A I would imagine--I can't recall exactly. To the best of my knowledge, I would imagine I talked to Bill

Young, who was our local Congressman, Congressman Young, and maybe to our Senators, possibly, Connie Mack and Bob Graham, and to other legislators who had the interests of Florida at heart.

Q Do you recall who they were when you say "other legislators"?

A I can't recall exactly. Oh, others in that?

Q Yes.

A At that point I do not know. As you go on, I will tell you others as we go further down. But at that point I can't say that I know of others that I personally contacted about that designation.

Q Do you recall anybody in the Navy that you spoke with in regards to that designation?

A To the best of my knowledge, I do not--I can't recall anyone. I just can't.

Q You mentioned a Mr. Anselmi earlier on in a response.

A Yes.

Q Who was that person?

A Ralph Anselmi was president of Tampa Ship at one point. It was during this particular period.

Q At the time the bid was submitted?

A Yes. I believe so.

Q Did Tampa Shipyard representatives go to Penn Ship

and inspect the two unfinished ships before submitting the bid?

A I believe they did, yes. You have to understand now that I'm kind of divorced from the everyday operations, but to the best of my knowledge, they did.

Q Therefore, it's correct, is it not, that Tampa knew exactly what they were bidding on prior to submitting the bid?

A As I recall, it was a very short time period that these people had to do their inspection of what they found at Penn Ship when they went up there.

Q But you do remember them going to Penn Ship?

A I do. I wish I could tell you the exact dates. I can't. But I do recall that they went up there for a visit.

Q Did the contract awarded to Tampa Ship include what's called an as-is/where-is clause?

A Yes. I believe it did because I questioned it with the guy.

Q What did you understand that clause to mean?

A Well, as-is/where-is, you see, in buying a ship, which I had been in the business--I'm not a shipbuilder. You bought a ship and you took her as she was, where she was, in the condition she was and the condition you had a right to expect her to be in.

For instance, if you bought a ship who still had 2

years to go on a Coast Guard 5-year certification, you had to believe that she was certified to operate, that the Coast Guard had made their inspections and that she was certified for 2 more years to go out and operate. You could operate it the next day.

Q So when you entered into this contract with the Navy, it was with the understanding that it was with an as-is/where-is clause?

A Yes. I remember Mr Anselmi telling me that.

Q But, yet, Tampa Shipyards in its lawsuit against the Navy claims the ships were not in the condition represented by the Navy. Now, how do you explain the apparent inconsistency between Tampa Shipyard's claim and the contract as-is/where-is clause?

A Well, if you look at a ship, I think you have every right to believe, as I told you, in buying a ship with Coast Guard papers, 2 years to go before your 5-year inspection, that she is seaworthy, she is ready to sail. I think that my people certainly would have had a right to go in and expect that the pumps and the generators and all of those very detailed exotic pieces of equipment were operable and were okay, because the Coast Guard, American bureau, which is the Government, the Coast Guard or the Navy with their inspectors should have been inspecting every piece of equipment that went into the ship. So you would have that

right. You're not going to sit there in a short period of time they allowed and open every generator or open every pump to see if it's working.

My understanding was--I did not go there, so I don't know what condition it was in at Penn Ship. I saw what they sent down when it arrived in flatbeds and just was placed in a huge parking lot that we had. It was like a crossword puzzle, a most gigantic crossword puzzle I've ever seen--jigsaw puzzle, I'm sorry. How you put the pieces where they belong, I just--I looked at it, and I said, "I don't believe this."

So I think that you should have been able to expect--you know, as-is/where-is carries with it certain, in my opinion, implications: implications that the Navy has inspected the equipment, if they pay for it they've inspected it and paid for the work that was done, and you should expect it to be Navy-inspected and okay and serviceable.

Q But you accepted it in the condition that you bid on--

A Yes, because I think--well, I didn't, but they did. But I'm sure they felt that they had every right to believe that the Navy had inspected the equipment. If they hadn't, then something was wrong there.

Q Isn't it correct that the original contract price

to have Tampa Shipyards complete the two ships was for $49 million?

A I believe that's true.

Q Yet by the time the contract was ultimately terminated for default, isn't it true that Tampa Shipyards had received $102 million from the Navy for those unfinished ships?

MR. BURNS: Excuse me one moment--

MR. DAMELIN: Excuse me.

THE WITNESS: I am not as up on the financial stuff of this as I should be. I don't--I wouldn't want to say exact figures on each thing. It's hard for me to do that.

BY MR. DAMELIN:

Q Is the $102 million figure familiar to you?

A That could have been around $100 million.

MR. BURNS: I want to take a minute.

MR. DAMELIN: Yes.

[Discussion off the record.]

MR. BURNS: Thank you very much.

MR. DAMELIN: Okay. Do you have any--

MR. BURNS: No.

BY MR. DAMELIN:

Q I want to just go back for a minute regarding the industrial base necessity issue and Mr. Ragan and your

dealings with Mr. Ragan. Did you have discussions with him personally about the approach that he was going to take in an effort to get Tampa the industrial base necessity classification?

A No. You have to understand the friendship with Bill Ragan went way back before this. I mean, he first came to us as an attorney with Ragan and Mason, his firm. They did much legal work for American Ship early on. I met him back in the--maybe late 1970s we were friends. Maybe early 1970s we became friends. So he had been with us, and he kind of came as an attorney, and then it sort of evolved into what you might term attorney/lobbyist. That's the fit there. That's how that evolved.

But Bill Ragan, when he would outline a plan or something, he would--I was not privy to it, no.

Q Who from your company was having those discussions with Mr. Ragan?

A I don't know that Bill--I think when it first started when we were talking about this, it probably would have been operational people. But it--

Q Like who?

A Well, like Mr. Anselmi possibly, and it would not have been a situation where Bill Ragan would have said, now, here's what I'm going to do, I'm going to do A, B, C. He never did that with me, so I wouldn't imagine he'd do it

with them.

Q Do you have any recollection of having such a discussion with Mr. Ragan?

A On the--

Q On the industrial base necessity issue.

A I may have had discussions, but he would not tell me, you know, about trying to get it and what we would do, what he would do for the shipyard--

Q Well, what did you--

A What I wanted to do was let us become a part of the base if we could possibly be that.

Q What did you understand Mr. Ragan was going to do?

A He might have seen certain people that he was close to. He was very quiet about what he did. He was very effective and very good with us and a dear friend and a fine man. But he would not say, like, now at 2 o'clock on this day I'm going to see so-and-so, so-and-so, and so-and-so. Once in a while he'd say I'm going to see so-and-so or this, but, no, he would not--

Q In connection with this particular point in time, do you recall him mentioning any names of Members of Congress that he was going to see or had seen in connection with the industrial base necessity?

A He could have seen--I don't recall him mentioning that. I went with him to see certain people just on a

visit, but that was later on in this total thing here.

Q At this stage, did you go to visit--

A I don't recall--

Q --anybody?

A No, I don't recall other than maybe the Florida Congress--the congressional delegation, that I would have any reason to see with him. I could have, but I don't recall.

Q Did you go with Mr. Ragan to see members of the Florida congressional delegation in an effort to get Tampa Shipyard classified as an industrial base necessity?

A I don't believe. I don't recall ever going with him to see a Florida delegation member on this.

Q Did Mr. Ragan ever tell you if he was going to talk to or contact any members of the Department of the Navy in connection with his effort to--

A I do not recall that either.

Q Let me finish a second.

A Yes.

Q In his effort to get Tampa Shipyards classified as an industrial base necessity?

A I don't recall that either, him ever telling me that, that he was going or taking me to see any member of the Navy. I do recall going in one time to the Pentagon with him, and I don't just know who he went to see or what--

I can't recall.

Q Was it in relation to this contract?

A I think it was at a time involving the TAOs, not being a part of the industrial base but involving the TAOs.

Q Later on in the process are you talking about?

A Yes.

MR. DAMELIN: Can we go off the record?

[Discussion off the record.]

BY MR. DAMELIN:

Q I want to move on now, Mr. Steinbrenner, to the time where Tampa Shipyards submits a request for a bailout. On May 26 and again on August 3, 1992, Tampa Shipyards submitted two requests to the Navy for approximately $25 million under Public-Law 85-804, which is commonly referred to as the bailout law.

The Navy refused your request for a bailout. What reason did the Navy give for denying Tampa's request for a bailout?

A At this particular time, I don't know that I was that heavily involved in the situation. I believe Mr. Nierenberg had come in as the president. And I believe that that application under the law you just stated was one of the avenues or perhaps maybe the only avenue that they found available to them.

Q Were you aware that Tampa Shipyards was applying

for a bailout under Public Law 85-804?

A Yes.

Q Was Tampa Shipyards encouraged by anyone within the Navy to submit the bailout request?

A No one that I know. Not that I know of. To the best of my recollection, I don't recall anybody telling me that the Navy had told them to do this.

Q Did you personally or American Shipbuilding or Tampa Shipyards take any action in an effort to obtain the Navy's approval of Tampa Shipyards' bailout request?

A Under that public law?

Q Yes.

A Not to the best of my recollection. Personally, I did not, that I can recall.

MR. DAMELIN: I'm going to mark a letter dated July 16, 1992, to Tampa Shipyards, to Mr. Nierenberg from Admiral Harshbarger as Deposition Exhibit No. 1.

[Steinbrenner Deposition Exhibit No. 1 marked for identification.]

BY MR. DAMELIN:

Q I would like you to read this letter, and in particular, it makes reference to a study by Paul Magliocchetti. If you would read that, please?

A Sure.

[Pause.]

THE WITNESS: Okay.

BY MR. DAMELIN:

Q Mr. Steinbrenner, the first paragraph of the letter makes reference to the fact that you--it says Mr. George Steinbrenner--"initiated a study by Paul Magliocchetti Associates of selected Tampa activities." And this is in connection with the bailout request.

First of all, let me ask you, does this letter refresh your recollection of anything that you may have done in an effort to have Tampa Shipyards receive the bailout request?

A Can I move back?

Q Sure.

A Coming up to this, in my two meetings with Mr. Cann.

When it was discovered that we were having problems, I asked Anselmi if I could go down with him to meet and to listen to what was going on with the Navy, because the reports I was getting back from my people were that they were not getting payments for work done and costs incurred in a timely manner. And, of course, I had those all the way through. There were invoices submitted for $750,000 that were being withheld over $50 items or $100 items by the Navy. And it became pretty obvious to me that

something was wrong, so I went down and I met with Mr. Anselmi. I don't remember whether Mr. Ragan went with us that day or not. I met with a fellow named Todd and a group of others.

Q A fellow named what?

A Todd. Captain Todd. I believe he was the project officer.

MR. BANKER: Program officer.

THE WITNESS: Program officer. Very nice man. And he sat and talked, and we had give and take on what was wrong. And after they left, I asked him could I see him a minute. I explained to him that, look, I am not a shipbuilder. I'm trying to keep this company going. I gave him the story of the jobs and all the things. And I said to him, What is wrong? Can you give me advice or some thoughts? And he said that possibly you require at that yard a change in leadership. And I said, well, that's fairly evident from the trouble we're having, at least from where you're coming from.

And I went a step further, and I asked him if he could give me any suggestions over where I might look. And he said to me that he might--he didn't like to, but he would give me some suggestions, not tell me "hire this man" but just suggestions. And he suggested to me a man named ~~Aaronberg.~~ Nierenberg

MR. BURNS: Is that Nierenberg?

THE WITNESS: What?

MR. BURNS: Is that Nierenberg?

THE WITNESS: Nierenberg. I'm sorry. Alan Nierenberg. And I said, well, where could I reach this fellow? And he said he's probably in San Francisco. He says this is only a suggestion, understand. I said I know. He's probably in San Francisco at the Naval Architects meeting going on.

So I said, I thanked him very much, and I left. I went and I called out there to the hotel where the meeting was, and I reached Mr. Nierenberg, and I asked him if he was interested in coming to meet with me at Tampa. He said yes. He had been heavily involved as the vice president of operations with Avondale and had been involved, I believe he said, with the TAO program. So he was quite familiar with it. And he left there, he told me, under conditions that, you know, he just didn't get along.

Nierenberg came with me. I found him to be very knowledgeable, a very good man. And that was the next phase--you have to understand I'm sitting back from it--the next phase in this development.

BY MR. DAMELIN:

Q For purposes of time sequence, was this before you--Tampa Shipyards makes the bailout request?

A I think it's before this takes place--no--yes, he came with us before this, yes. I'm trying to lead to this.

Now, I'm recalling the best I can, things got worse according to the Navy people, and I began to get suspicious because I was getting the same stories that I got before, that maybe somebody wanted us gone. I then had two meetings. I don't think it was specifically, in my recollection, with regard to 75--the 85-04.

Q 85-804.

A Yes, 804. I think the reason that I went down and met with Mr. Cann the first time was to try and tell him the problems that my people were telling me they were having and that all I wanted to do is deliver these ships and do the job for you, but that what my people were telling me, it isn't. And couldn't he see if he couldn't do something to look into it to see if we were, in fact, getting fair treatment?

Q Who is Mr. Cann?

A He was number two or three in the Navy, because I went into the Pentagon to see him. A very good man. He struck me as very knowledgeable, very good man.

Q Who did you go with when you went to see him?

A I was sitting with him myself the first time in his office.

Q Continue on leading up to the study by Mr.

Magliocchetti.

A Well, we then came around to the point where we were hearing--I'm hearing both sides, and I'm not in the yard. I'm not working there, and I don't have headquarters there, and I seldom went there. So it was determined that we would get Mr. Magliocchetti--who had a great deal of knowledge in the times that I had met him. He had been working in the same building and possibly the same type of office as Mr. Ragan. And I was impressed with his knowledge, and I think that he had specific knowledge not only on shipbuilding but on the TAO programs.

So as time went on, I said, well, I will get Mr. Magliocchetti to put together a group to tell me, come in with a team or whatever it requires, to tell me who is wrong and what's wrong. So we did that, and he came up and he came in with a group of people that really impressed me. There were about two or three admirals on this group who had been deeply involved with the Navy and other experts, other people--a financial man from Bath, and I can't remember his name. I remember the shipyard he came from. It was very good. And they put this group together, and they came in and looked at us from top to bottom. Because, you see, I wanted to know what we should do, and they came up with a set of recommendations.

Now, Mr. Magliocchetti I believe was asked to

provide some of what he had found to the Navy, to present it to the Navy and to people on the Hill. And I told him I'm in favor of that. Let's find out what the problem is--which he did. And at the second meeting that I was in there, we sat at a long table. The Navy sat on this side, and we were on this side [indicating]. And after that was complete, we presented the problems that we were having and the fact of the condition of the ships that we received and what we did that we thought was right and we weren't getting paid, and had that meeting, came out of that meeting, and I believe after that meeting we were turned down.

Q This meeting that you just made reference to, the second meeting, was this during the time that you had submitted and were waiting for action on your bailout request?

A I don't know. We may have been already denied that, but we went down trying to find out what the problem was. If I could tell it to you in simple terms, we didn't feel we were playing on a level playing field. We saw things happening with other people, and we were not getting those same treatments.

Q Prior to the time that you utilized the services of Mr. Magliocchetti to do this study, had you ever utilized his services previously?

A I think we may have just talked and done things,

but at this particular point it was the first time it was full blown.

Q Was he recommended to you by Mr. Ragan?

A I don't know whether Mr. Ragan recommended him. He was working in there at one point in the same office building and, if I'm not mistake, the same office.

Q Did you meet Mr. Magliocchetti through Mr. Ragan?

A I don't recall that, sir.

Q Did you meet Mr. Magliocchetti in Mr. Ragan's offices?

A I don't know where I first met him. I don't know whether it was in his offices.

Q Do you have a recollection of where you first met Mr. Magliocchetti?

A No, I don't. I couldn't tell you.

Q What did Mr. Magliocchetti's study conclude?

A Well, I think it made recommendations to us. it did not, certainly, totally agree with the Navy. And when I say "the Navy," I mean the people that were the contracting people. It left me with a feeling sitting reading it and studying it, yes, we needed to improve certain things. But to say that we were a total loss or that we couldn't build ships, no, it did not tell me that.

Q But Mr. Magliocchetti did the study, and you gave this to the Navy; correct?

A I believe he worked with Navy people with the study.

Q After he gave the Navy the study or told them about the study, the Navy denied your bailout request; is that correct?

A I'm not sure whether they had already denied it. I don't know the timing of that, Harold. I just don't know it exactly.

Q The letter, if you would look at the first paragraph of the letter, does that indicate to you that the Navy had reviewed Mr. Magliocchetti's study or been made aware of its findings prior to them denying the bailout request?

A Yes, withhold a final decision. This is Admiral Harshbarger. And it appears that that's what he's saying there. So I think--I didn't--it was more than that for me. It was more than 85-804. Significantly, I sit back, I hear 85-804 is granted to Avondale, but not to Tampa Ship. I just wanted to know what made us different than what I was hearing--and I'm pretty sure I'm accurate in that--other yards were getting.

Q Now, this letter that I have given to you, Deposition Exhibit No. 1, is dated July 16, 1992. And in pertinent part, it states that "Based on NAVSEA's analysis of Tampa's original request and PMA's revision, there do not

appear to be adequate assurances to the Navy that, even if relief is granted, Tampa can complete performance of the contract." And that is in July of 1992.

A All right.

Q Now I want to move on and turn to October 1992, just a couple of months later, and in October 1992 Congress passed an appropriations bill that, among other things, increased the ceiling price on the oiler contract by $45 million. And that's the part of the appropriation I want to talk to you about right now.

A Okay.

Q The increase of $45 million of the ceiling price. My question to you is: In connection with that congressional appropriation, what action did you personally or American Shipbuilding or Tampa Shipyards take in an effort to obtain congressional approval of the appropriation to Tampa Shipyards?

A As I recall, it was more general than specific. I can recall at that point we tried to enlist the help of the Florida Senators and Congressmen, that this was a Florida company, that it was the largest industrial employer in the Tampa Bay area, and what we wanted--what it became with me was almost an obsession to find out that we were being treated ~~the same as~~ differently FROM everybody else, not ~~differently~~ the SAME. When I would hear stories coming out about we are turned down on

85-804--is that--

Q Let's call it the bailout.

A The bailout. I don't like that term. The bailout. And I'm sure you don't either. On the other hand, Avondale is granted it, that when we asked for release of retentions to help us get over our financial problems--and let me point out that all the shipyards that I knew about, from what I know, had financial problems, including all of those that we've talked about today had serious financial problems, NASCO, Avondale, just like we did. But then when they asked for public relief, they're given it and we are turned down. And then when we ask for release of certain retentions so that we can proceed and ease our cash problems, we're turned down; Avondale is given it. That the Navy comes to me as a person, as a shareholder of 10 percent of the company, okay, and as a sometimes officer, sometimes not, depending on who was there and what I was trying to do, and tells me I have to make personal guarantees in order for this company to get fair treatment--I mean, to get these things which it earned, in my opinion. I've never heard of that, and I don't believe it's ever happened in the history of the U.S. Navy.

So all I was trying to get from these people was just be sure we're on a level playing field and treated the same.

Q But I want to focus, if I can, now on this--and I'm going to get into that other question about the personal guarantees a little bit later.

A Okay.

Q But I'm looking now at the period between July 1992 and October 1992 where--between that period of time, I want to know what, if anything, you did or people at your direction did in an effort to try to get the congressional appropriation, which was, in fact, awarded to Tampa Ships in October 1992.

A You're better on the time slots than I am.

Q I realize that. That's why I'm trying to help you.

A If I seem vague or I'm a little out of the time slot, it's because I just don't know the exact dates.

Q Let me ask this: Did Mr. Ragan do anything to assist you and/or Tampa Shipyards in getting the congressional appropriation?

A Well, I'm sure he tried for us, yes. I wouldn't say he didn't. As to exactly what he did, I would have to say I don't know.

Q Do you recall going with Mr. Ragan to any meetings with Members of Congress to discuss the appropriation?

A I went to meetings with Mr. Ragan on maybe two occasions. I can remember going to meet with him in Senator

Inouye's office, and I can remember going to meet with him in Congressman Murtha's office and Congressman Young's office. And maybe there was one other, but to the best of my recollection that was it.

Q And was that to discuss the appropriation?

A It was at one time or another during this whole thing. See, there, again, I'm a little at a loss for time.

Q Did you ask Senator Inouye to assist you in connection with the problems you were having with the Navy?

A When I went in, no. You have to know Senator Inouye, and I've known him for some time. I just said--and I said to every single person I went to, all I would like to have is fair treatment. I would like to be playing on a level playing field. I never asked them specifically do this, get me this money, do that. Never. The two that I think of mostly would have thrown me right out of the office, I think, if I had ever said that.

Q Who were the two you think of--

A Well, I mean, just about every one of them, but I doubt--but John Murtha and Senator Inouye would have just said, "Get out of my office."

Q Had you known Congressman Murtha prior to 1989?

A I don't know when I first met Congressman Murtha. I couldn't give you an exact date.

Q But you knew him at some point in time when Tampa

was dealing with the Navy oiler contract problem?

A Yes.

Q Do you recall if you knew him before you got involved with the Navy oilers?

A I don't--can't recall exactly when I first met him.

Q What about Senator Inouye? Had you known him prior to--

A Senator Inouye, I knew him many years back.

Q Now, prior to Congress passing the appropriations bill, did any Members of Congress come down and visit Tampa Shipyards?

A Yes.

Q Which Members of Congress visited Tampa Shipyards?

A Well, whenever this particular visit took place--see, again, I'm at a little loss on the calendar. There was a day when Congressman Murtha, Congressman Young, and the Under Secretary of the Navy came to Tampa to see the ships. And I believe the Under Secretary's name was Howard. I couldn't believe the whole thing because it kind of reaffirmed my faith in Government, whereas at times I think an average citizen would say the hell with them.

These fellows got up at 4:30 in the morning to catch a flight--they had two places to go. They came into Tampa. The temperature must have been 95 to 100 degrees

because I was in short sleeves; I was really hot. I went down to the shipyard that day to be there when they were there.

Q You knew they were coming in advance; correct?

A Yes, we knew they were coming, and my people told me.

Q Who arranged that visit, Mr. Steinbrenner?

A I don't know how that was arranged exactly. I'm sure that we probably at one time or another said, Please come down and look. But I didn't expect what I got.

Q Did you know in advance that these people were coming?

A Yes, we knew. We knew. I don't know how many days in advance. It wasn't a long time.

They came--I told you how uncomfortable it was. They came inside. We sat down. I sat in back, and they sat with my operational people, who had a bunch of charts and explained--showed pictures of the condition of the ships when we got them, and then showed pictures of how the ships were now, which I thought was very conclusive that we were making real progress.

They then told them the trouble they were having with the Navy of getting payment in a timely manner. Now, this fellow, Mr. Howard, who was, I believe, Under Secretary or Assistant--I don't know all the terminology--was a very

interesting man because he sat--he was a young guy, and he really asked questions and took in what was being said, as did John Murtha.

Now, I thought it was going to be over, and I thought, you know, that I'd expect these guys to say, all right, thank you, we've got the stuff, we're going back. They didn't. They wanted to tour the ships. And I walked with them, and we must have spent 2-and-a-half hours, 2 hours anyway, going through the ships, going through crawl spaces that you wouldn't expect they'd ever look at. But they did. And I stayed at the back with one of the young men from the Navy that was with the Under Secretary, and I said, "I don't believe what I'm seeing here." I mean sweat pouring off everybody. They went into tiny space, expanded space, crawl spaces. They just wanted to see what was going on and have it explained to them.

As I said, that kind of reaffirmed my faith in people in Government, that they really cared.

So, finally, they left and as they left they said you showed us something today, and the one point that this Under Secretary said he was embarrassed about was the fact that the resident guy, the head guy of the program in Florida, a guy named Klein, didn't even show up, didn't come down. And here is the Under Secretary of the Navy and two leading Congressmen, and this man didn't even show up.

Didn't show. And right then that rang a bell with me, and he had apologized for that fact.

As they left, I think they were convinced that we were doing the job and trying to get this thing done, but that not giving us an even playing field to play on was hurting us.

Q What representations were made to you by any of these Members of Congress regarding further funding for Tampa Shipyards?

A I don't know that they said that--

MR. BURNS: If any.

THE WITNESS: Yes. I don't know that they said that.

BY MR. DAMELIN:

Q Was there any indication to you that they were going to review the situation in an effort to possibly provide you further additional funding?

A One thing the Under Secretary said as he left was he said we're going to see if we can help you. But it was more of a statement. It didn't involve money. It didn't specifically go to any point. So I could answer that no, they did not promise me anything.

Q Prior to receiving the appropriation, Mr. Steinbrenner, in roughly October 1992, were you aware that this was a matter that was being considered by Congress?

A I think I probably was aware of that. I can't be sure what dates I was, but I would assume that I would have been aware of it, hearing from the people that were, you know, in the yard when I talked to them.

Q So the fact that you got the appropriation didn't come as a total surprise to you?

A Well, I can't say that it was or wasn't a surprise. It was certainly something I was hoping for because I felt we deserved it.

Q And after the congressional visit by Congressman Murtha--and who were the other Congressmen?

A Congressman Young.

Q Were you encouraged that you might have increased your chances of getting some additional funding to assist you?

A Let me say that I felt that what they were shown, I was seeing for the first time, too, and that it was impressive to me, and I hope it was to them, too. That's as much as I can say.

Q Did Mr. Ragan arrange that visit, to your knowledge?

A I don't recall who arranged it, how it came about.

Q You had mentioned--let's talk about Mr. Ragan for a moment, if we can. Is he still alive?

A You know, I tried to find out. I just ran into

somebody that used to know him, and I said, What do you hear from Bill Ragan? And he says nothing; nobody seems to know; nothing. Whether he's alive today or not, I could not say.

Q Approximately when did you first meet Mr. Ragan?

A In the late 1970s, or in the 1970s.

Q Is he an attorney?

A Yes, he was an attorney, and a very good attorney.

Q Had you used him on legal matters in the past?

A Only maritime, as I recall.

Q What services did Mr. Ragan perform for Tampa Shipyards in connection with the Navy oiler matter?

A I think probably you'd have to say, as I've tried to tell you before, that it evolved from a legal man to a legal/lobbyist.

Q Did you retain Mr. Ragan to perform legal services in connection with the Navy oiler matter?

MR. BANKER: Did he for himself, or he for Tampa?

BY MR. DAMELIN:

Q Did you personally and/or on behalf of Tampa Shipyards and/or American Shipbuilding retain Mr. Ragan to perform legal services?

A He was there as our attorney in Washington, and they probably did utilize his legal expertise in that, yes. I don't know exactly what they talked about.

Q Did you view Mr. Ragan as a lobbyist in addition

to being an attorney?

A I viewed him as a fine maritime attorney who knew his way around Washington, who had many friends, and who deserved to have many friends. He was a very fine man. Whether I said you are a lobbyist, no, I think that's what happened. I think it was a combination, is what I'm trying to tell you.

Q In connection with this matter, the Navy oiler matter, did you view his services being both as a lawyer and as a lobbyist?

A As I would say--I don't know the exact ~~terminations~~ terminology. I mean, this city is full of lobbyists who are also lawyers.

Q Yes.

A And it's not against the law and--

Q Nobody is saying--nobody is alleging that it is.

A I would say yes. Yes, I probably did view it, if I was sitting down considering all of that.

Q Now, I believe you stated earlier that you had attended some meetings with Mr. Ragan and Members of Congress; is that correct?

A Yes. Bill would take me into those meetings, and then I'd have about 3 or 4 minutes to--you know how busy these fellows get--to express the hope once again that we would be treated fairly.

Q Who do you recall meeting--Members of Congress now I am talking about. Who do you recall meeting with Mr. Ragan in connection with the Navy oiler matter?

A To the best of my recollection, Congressman Murtha, Congressman Young, who I believe he accompanied, Senator Inouye, and maybe there were one or two others. But those I remember.

Q Do you remember the one or two others?

A No, I can't.

Q What was the total amount that Mr. Ragan or his firm billed you personally or Tampa Shipyards or American Shipbuilding for the services he performed concerning the oiler contract?

A I do not know.

Q Can you check on that and provide that information to us?

A I suppose.

Q I would like you to do that, if you would.

Do you know the total--

MR. BANKER: Excuse me, but the best he can do is try to do that.

THE WITNESS: Yes. I just said I would try.

BY MR. DAMELIN:

Q I'm assuming--

A That firm is gone. Their firm is gone.

Q Their firm is gone, but I'm assuming that Tampa Shipyards and/or American Shipbuilding and/or you personally have records to that effect. And my next question is: In addition to the total amount that he or his firm billed, I'd like to also know the total amount that Mr. Ragan or his firm was paid by either you personally or Tampa Shipyards or American Shipbuilding for the services he performed concerning the oiler contract.

A I'll do the best I can for you. Yes, sir.

Q I believe some of that information may overlap with some of the requests that were made at the hearing when Mr. Boyles testified.

Now, I'd like to turn to Mr. Magliocchetti, if I could for a moment, and have you describe for us, to the best of your recollection, everything that Mr. Magliocchetti did for either you personally, Tampa Shipyards, or American Shipbuilding in connection with the oiler contract. You've already indicated the one study that he had done for you. Did he do anything else?

A That I can recall, he may have tried to advise my people sometimes what to do, but specifically I think that the study was the big thing.

Q Did he arrange for you or members of your companies any meetings with Members of Congress?

A I don't recall that he did. I think at the time

that the study was being done, when it was completed, I would also have considered him as a part expert--I don't think he's an attorney; he might be--a part expert in the fields we were dealing with, the TAO tankers, and part lobbyist. I mean, that's being as honest with you as I can.

Q Do you recall him telling you about any Members of Congress that he met or had conversations with regarding the Navy oiler matter?

A I cannot recall him telling me specifically of this Member or that Member that he met on our behalf with the TAOs. He may have. I just can't recall. You've asked me enough. I just don't recall.

Q Did he ever arrange any meetings for you with Members of Congress to discuss the Navy oiler matter?

A I don't recall him arranging meetings for me. I think he had close relationships with some of the men because, as I understood, he had served with that committee.

Q Which committee is that he served?

A I believe in the Committee on Appropriations.

Q On the Senate or the House side?

A I think the House side.

Q Who was his close relationships with?

A Well, as I say, I imagine that since he had served there, he may have had them. I could--

Q Specifically, do you know if he had a close

relationship with Congressman Murtha?

A I do not know specifically. I knew he knew him, yes.

Q You knew he knew him?

A Yes.

Q As I had asked with Mr. Ragan, I'll ask you with Mr. Magliocchetti. What is the total amount that Mr. Magliocchetti or his firm billed you personally or Tampa Shipyards or American Shipbuilding for the services he performed in connection with the oiler contract?

A I couldn't answer that.

Q Could you also check on that?

A I will try. Yes, sir.

Q And the same question also, I'd like to know the total amount that Mr. Magliocchetti or his companies were paid by either you personally or Tampa Shipyards or American Shipbuilding for the services he performed concerning the Navy oiler contract.

A I will try.

Q Mr. Steinbrenner, did you personally or American Shipbuilding or Tampa Shipyards employ any other lobbyists since 1989 regarding anything to do with Tampa Shipyards?

A Not that I can recall, sir.

Q In the course of your testimony so far, you've mentioned various Congressmen and Senators. You've

mentioned, I believe, Senators Mack and--is it Graham?

A Yes.

Q And Senator Inouye and a number of different Congressmen in the course of your testimony. Since 1989, have you personally or your companies made any contributions to any of those individuals' political organizations?

A We are very careful on that. I would say probably we have since 1989, but not in probably the amounts or numbers that you fellows are familiar with from defense contractors.

Q Could you provide for us in a supplementary submission, if you could, the dates and amounts of the contributions and the individuals to whom the contributions were--

A Total contributions?

Q No. What I would like is--

A To these men I mentioned?

Q --for the members of the Florida congressional delegation that you've mentioned, in addition to Senator Inouye, in addition to Congressman Murtha.

A Sure.

Q You said that the Senators from Florida also--

A Yes, I--

Q The Senators and the Congressmen, if you could.

A I think we could probably do that, yes.

Q Thank you.

In his testimony before the subcommittee, Mr. Boyles, who was or is Tampa Shipyards vice president for finance, stated that you offered to personally guarantee that the ships would be completed for the contract price and that you would personally be responsible for certain excess costs in completing the ships, and the Navy rejected that offer. That was Mr. Boyles' testimony.

Could you please explain the specific details behind your offer and the results of your offer to the Navy?

A Well, that statement is accurate, sir. I don't believe it's ever been done before or probably never will be. As I said to you before, I don't believe any individual has ever been asked to guarantee the Navy contracts in the history of the Navy doing business with shipyards.

Q What did you offer to do, Mr. Steinbrenner?

A Well, when it became so apparent to us in my judgment--I'm not in that yard every day, but I listened to one group after another tell me the problem they were having and that certain people they felt were out to prevent American Ship from completing these ships, for whatever reason. I began to become a believer. We brought in a man that the Navy said would be a good man, and he couldn't get it done. And he was a good shipbuilder.

We brought in the group, this total committee that

we brought in and paid a lot of money for, that gave us what I thought was an excellent study, and those people couldn't handle it. And always it came back the same thing. Somebody up there doesn't like you and doesn't like us.

And so when we were discussing, I said, well, one sure way that we can be different than all of the yards that are getting these things done for them, getting huge, huge bailouts, getting that law passed okayed for them, getting retentions released that they won't do for us, is to say to the Navy on the basis of this negotiated contract we will go with this contract, and if it exceeds the contract, I will personally pay for it. Because my people felt that we were--that our figures were accurate because we're at the yard what it would take to completion, as compared with the Navy who were doing their figures in Washington on the basis of formulas and weren't in the yard.

And so I felt that if I did that, it would try to show them. We had gone through several Defense Departments audits, very thorough audits--those men were in there looking at everything--and had passed. Yes, what we're representing we've incurred, the costs are accurate.

At one point, I believe even--I don't know if it was before or after--the inspector general came in and found no wrongdoing of any kind. And if all of these men were saying those things, I felt comfortable in making that offer

because then we would find out once and for all whether what we were doing and what I was led to believe is right and what the audits showed was right was right.

Q Where did you first make that offer? Do you recall?

A I don't know the exact date, sir. I couldn't tell you.

Q Where.

A Where? Well, I made it to my people, and I believe that they took that then to Washington, to the Navy.

Q Was that offer ever placed in writing?

A I believe. I don't know for sure, but I believe.

Q And did the Navy respond to that offer?

A My understanding was from my people that the Navy turned that down. Then I just threw up my hands.

Q Did your offer come prior to or after the Navy had sent you a cure notice?

A I believe possibly it was after, but I'm not sure of that. I'm not sure.

Q But you do recall that it was in written form at some point in time?

A To the best of my knowledge, it was. But it was certainly conveyed to them, and I believe it was conveyed in writing.

Q Mr. Steinbrenner, as a result of the two contracts

that were covered by the 1992 congressional appropriation, and it was the--I believe it was the crane ships.

A Crane ships.

Q And the Navy oiler contract in the appropriation. As a result of those two contracts, Tampa Shipyards received an immediate cash infusion of more than $25 million.

A Yes, sir. I believe that's right.

Q Is it correct that $2.2 million of those appropriated funds immediately went to pay you for loans that you had made to Tampa Shipyards?

A I don't know it was immediate. About $2.2 million went to me to repay one loan. I had many loans still outstanding with the company.

Q But that was the money that was appropriated in Congress?

A That came from the crane ship appropriation.

Q Is it also true that an additional $8 million of those appropriated funds were used to substitute security for two letters of credit that you had personally guaranteed?

A Which moneys went to pay for the ship and for labor and material.

Q But initially you were relieved of $8 million of guarantees that you had placed on some security?

A Yes, you have to understand this, that--

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Q Just, first of all, is that correct?

A That money went to pay for labor and material on the ships, yes.

Q Eventually. But my point is--

A Well, no--

MR. BURNS: I think it was already there. I'm a little confused--

MR. DAMELIN: Okay.

MR. BURNS: I just want to stop for one minute and confer with Mr. Banker.

MR. DAMELIN: Sure.

MR. BURNS: We may be able to clarify.

MR. DAMELIN: That's fine. If you want to step outside, that's perfectly fine.

[Recess.]

MR. BURNS: Harold, thank you very much.

MR. DAMELIN: Okay.

BY MR. DAMELIN:

Q Mr. Steinbrenner, let me re-ask that question and then you can explain also what happened to some of those funds. The question is: Is it correct that, in addition to the 2.2 that went to pay off the loans from the appropriated funds, an additional $8 million of those appropriated funds was used to substitute security for two letters of credit that you had personally guaranteed?

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A Can I explain, Harold, what I'm trying to say to you?

Q Yes.

A You have to understand, somewhere there are people that think that George Steinbrenner has got a million here and a million there. That isn't the way it worked.

When we got in trouble, as we progressed and weren't able to get payments paid to us, weren't able to get the retentions released, weren't able to get help under the public law, this company, these men were in danger of having no money to be paying--if we couldn't buy materials, we couldn't finish. So I was pouring millions. But what was done, and what was done at all stages of this, including since the bankruptcy, I arranged with the bank to supply lines of credit to American Ship. This was not money out of my pocket. I didn't take cash and take this. They insisted that if I were to do this, if they were to do it for us so we could complete the ships, I would have to say--if they didn't pay American Ship, I would have to. Simple guarantee.

But it seems to be growing into something that George Steinbrenner got this in his pocket. I got $2.2 million, or whatever you said. But at the time I don't know how many millions--millions that I had arranged for the company to have.

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Now, your question was where it went. All I know is that the money was used for labor and materials.

Q My question--

A Now, if it did reduce those lines that they had at the bank, then what you say is accurate.

Q Of the--

A I should say that the company had at the bank. Go ahead.

Q Excuse me?

A I should say the lines of credit that were provided by the bank for the company, with my assurance that I would pay if they didn't get it.

Q Okay. Just to clarify the record, I think we're talking about the same thing, but are we saying now that, in fact, of the appropriated funds, $8 million of the appropriated funds was initially used to substitute security on two lines of credit that you had personally guaranteed previously, then when you got the appropriation that money was used to secure the line of credit--

A That was--

Q --and you were relieved from that?

A Yes, that were used, but at the same time I was putting more in, that were relieved for payment of labor and materials as the Defense Department audit specified and as the inspector general said.

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Q Subsequently?

A Yes.

Q Turning to the $18 million settlement that was recently agreed upon by Tampa Shipyards and the Government, talking just about that, how much did you or will you personally receive from that settlement?

A I don't know the exact amount because the money would go, when it came in, directly to the bank toward the American Ship line of credit. None of it came to me or my account. I still owed all those loans.

Q You're saying you're going to get nothing from the $18 million settlement?

A Except a release of my guarantee if, in fact, the company failed.

Q I don't understand that. Can you explain that?

A Well, you see, when we couldn't get the money, George Steinbrenner didn't write a check to American Ship. We had to go somewhere to get it. So I went to a major bank, and I said to them this company needs help, will you please give us a line of credit? Not without your guarantee, Mr. Steinbrenner. We don't want your cash. We want your guarantee. Those moneys were then given to American Ship as needed. They could call down on it, and I would sign off and say okay, and the bank would pay them. And I was on there for the guarantee.

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So it isn't technically money coming into my account or to me. It's used to pay off that line of credit, where I am a guarantor. But, again, I say I don't know of a single shipyard in the world that was required--in this country that the Navy ever required a person to do that for.

Q How much of that $18 million settlement then will be used to relieve you on loans that you were the guarantor?

A To relieve me of the guarantor but to repay the loans, which the moneys were used for keeping the company going. I don't have an exact figure on that, sir. I can't tell you exactly. That's handled--

Q Do you have an approximate figure?

A Oh, I don't know. There was a $4.5 million approximate loan from the bank to the company for purposes of workmen's compensation guarantees, so that we could be sure that the men had workmen's compensation. There was about another $4 million or something. I don't have that--maybe if somebody else--or, Bob, if you have it. I don't have an exact figure.

MR. DAMELIN: Mr. Banker, do you want to consult with Mr. Steinbrenner on that?

MR. BURNS: Let's take one moment.

MR. DAMELIN: Yes.

[Discussion off the record.]

THE WITNESS: But understand one thing: the

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distribution of those funds is governed by the bankruptcy court, Federal bankruptcy court, distributions as to where it can go and where it can't go. I was not particularly happy on that settlement because I believe that we had a very good case and I think in materials that I had been shown that were uncovered in our lawsuit against the Government, the Navy, the Navy made it very clear that they had some serious problems with the case, the Justice Department did, and that they'd better get in and get it settled, that they had, in fact, wronged American Ship.

Now, I'm not blaming specific people, but we have that document, and I assume you have it.

BY MR. DAMELIN:

Q But if you say you're not satisfied with the settlement, why did you settle?

A I thought it should have been more. Because, you have to understand, I wanted to get it over, because when you sue the Navy, you may wait 2 to 5 years to get settlement in the Court of Claims. And what was going to happen with the men and the company and with the bankruptcy proceedings? The judge at the last time complimented me--and I don't know this man--said this never could have happened to get this thing settled for the creditors. The shareholders voted for the plan 90-some percent. The creditors voted for the plan of settlement, and it was

approved by the Federal court, the Federal bankruptcy court. So it was so legal and so squeaky clean that I just have to tell you that--

Q I want to go back to the settlement because I think we might be confusing certain things. I've seen the settlement agreement, and I've seen various press accounts. I understand that part of the settlement is going to go to NationsBank.

A Yes.

Q They're going to get a proportion of the settlement.

A Yes.

Q But I also understood from the settlement that you would get a certain amount of cash that would basically go to repay certain loans that you had made to the company from that $18 million settlement. Is that correct?

A NationsBank, I had to buy that loan. They were closing in on us. They wanted their money, and I don't blame them. They were very patient with us. That loan I bought, but with a stipulation that if we did settle the Navy claim, they would get this amount, which was almost what they had in there.

Q How much was that?

A Over $3 million.

Q That's NationsBank?

A Yes.

Q Are you getting any other loans paid off from the proceeds of the $18 million settlement?

A Other than loans that were used by me and that were approved by the court, no. I will lose substantial millions in this total transaction.

Q Let me do it this way: At the time of the settlement--

MR. BANKER: Do you want to do a time out?

MR. DAMELIN: Yes.

[Recess.]

MR. DAMELIN: We'll go back on the record, and we don't have too much more to go here.

BY MR. DAMELIN:

Q Staying with the settlement for a little bit, Mr. Steinbrenner, let me ask you this question and phrase it a different way to see if we can try to get a better understanding.

A Okay.

Q At the time of the settlement that was recently consummated between Tampa Shipyards and the Government, what was the total amount of loans that you had personally made, not guaranteed but personally made, to Tampa Shipyards and/or American Shipyards which were still outstanding?

A Going all the way back?

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Q No. At the time of the settlement, how much in loans had you personally made to either or both of those companies that were still outstanding?

A I don't want to appear like I don't know what my own money is doing, but most everything that was post is the bank, not personal. In fact, it was. And going way back in the era of the 2.2 and those, I believe $1.5 million was a loan that I made to--direct, out of my own money, and I'm not sure personally how many--I just couldn't tell you. I know the $1.5 million, but I couldn't tell you an exact amount.

Q Moving up again to the time of the settlement, are you saying that of those loans that are outstanding, you're just the guarantor on those? They're not personally made by you?

A Yes. I believe that way back there may be some others that I am owed--I mean, back in the '80s. We've gone through all this. But right for keeping this--since we filed for bankruptcy and keeping this company going since the date of the filing, I would say it is all the bank.

Q The bank, and you're just a guarantor?

A I'm the guarantor. Of course, they're going to come after me, but I'm just the guarantor. That's my best belief.

Q And let me also try to get a clarification. Of

the $2.2 million that you received from the appropriated funds, was that a loan that you had personally made?

A Personally.

Q For the total 2.2, or you said 1.5?

A Well, no; 2.2 was one of the loans that we paid. The board of directors felt, when the president went to them, that they should repay that loan because it was a higher, much higher interest rate. It was tied to prime

Q So that 2.2, did that include interest also?

A No. No, that was the cash amount. And the 1.5 was a cash amount. But those were way back, and there are some others back there. I don't know how much.

Q Are we confusing the 1.5 and the 2.2--

A There's two separate loans. Separate loans, yes, sir.

Q The $2.2 million that you were repaid, was that the amount of the loan?

A That was the amount of the loan. I don't know that it had incurred interest. It was the amount of the loan, and the board determined that they wanted to pay that one because the interest on it was so high.

Q Staying with the $18 million settlement, from that settlement how much in dollars have or will Tampa Shipyards creditors receive?

A I don't know that I can tell you the exact dollar

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amount they're going to receive. They're going to receive--they settled it on a formula, the attorneys for the bankruptcy, and I don't know what percent they agreed to. But whatever it was--I wouldn't want to give you the wrong percentage here. Whatever it was was approved by the creditors by a 90-plus percent vote, which my lawyers said was unusual, the bankruptcy lawyers, and also by the shareholders, by a 90--

Q But you don't know how much they're going to receive in total?

A I wouldn't want to say the total dollars or the percentage. There is an agreed-upon percentage.

Q What about in terms of cents on the dollar? Do you know how much the creditors are going to receive then?

A No. Most bankruptcies, they don't receive much because you can't determine totally--the formula has been set and voted upon, and I don't know exactly what the percentage is. I've left the attorneys for the bankruptcy handle that, or what the dollar figure would be.

Q We've seen the term five cents on the dollar that creditors will receive as a result of that settlement. Is that accurate?

A I do not know that.

MR. BURNS: It's my recollection that Mr. Boyles--I could be wrong--testified ten cents on the dollar.

BY MR. DAMELIN:

Q What I'd like to do is, if I could, ask your lawyers to provide, if they can, information relating to that also in the sense of how much the creditors will receive from the settlement in total dollar amount and what that translates into cents on the dollars.

A I may--

MR. BANKER: I can't do the second one because most of the claims are being contested. I can do the first.

MR. DAMELIN: Fine.

MR. BANKER: The first is very easy.

THE WITNESS: I'm a member of that group, and I don't even know.

MR. BANKER: In order to determine cents on the dollar, I have to wait until we determine what the valid claims are.

MR. DAMELIN: I'd like to know--

MR. BANKER: We can't do that. The creditors committee is handling that.

MR. DAMELIN: I'd like to know the total amount.

BY MR. DAMELIN:

Q Now, Mr. Steinbrenner, of the loans you guaranteed, let's talk about those and see if we can maybe get a little more clarification.

A All right.

Q Of the loans you have guaranteed to Tampa Shipyards and American Shipbuilding, how much will be remaining, after settlement how much will be remaining unpaid and, therefore, you will be asked to possibly pay under the guarantees that you've made?

A Can I have a moment with the attorney?

Q Yes.

[Witness confers with counsel.]

THE WITNESS: My understanding is, from the attorneys and the accountants, that I will lose, will not receive back approximately $8 million.

BY MR. DAMELIN:

Q That you--

A That is owed me. That I've either guaranteed or loaned.

Q When you say that you've either guaranteed or loaned and you'll lose $8 million, is that because you're going to be forced to pay $8 million of loans that you guaranteed?

A Yes, that plus moneys that I loaned outright, like the $1.5 million that I never got. See, now, in addition to that, I must tell you that it's hard to give that figure exact because we're in the process of attempting to sell the company, and in order to sell the company, somebody had to put in a lot of cash to keep it going so that we could

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arrive ultimately--that was one of the reasons for keeping the company going. It cost me approximately, they are figuring, $600,000 a month to keep this company going. That's what they're projecting each month, that I've been paying about $600,000. And one of the people that is looking at the company is asking for 90 days, and they've come to me and they said if we go with that offer, that means that if they won't pay that--and we're negotiating that right now--I would have to put that in.

Q That $600,000 a month that you are paying now, are those in the forms of loans that you're making to the company that will be repaid to you when and if the company is sold?

A We are trying to negotiate with them that if they're going to take 90 days--this is one of the two offers. If they're not going to close by May 31st, if it takes--

MR. BANKER: Excuse me. You can't get into that because one of those offers is still confidential.

THE WITNESS: Oh, okay.

MR. BANKER: I'm sorry.

BY MR. DAMELIN:

Q The question is, the $600,000 a month that you have stated that you are contributing, is that in the form of loans you are making to Tampa Shipyards.

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A Bank. Bank. Same at the other. Staying away from me.

Q I'm sorry. I don't understand.

A I'm just--

Q You said you were contributing--you just said a few minutes ago you were contributing $600,000--

A I have to guarantee that.

Q To guarantee. The bank is contributing on a loan, and you are the guarantor.

A Yes, sir.

Q Okay. That gets into something else you had testified earlier that I just want to clarify. Several times during your testimony you had indicated that you were required to make personal guarantees on loans during the course of the contract. Under what circumstances were you required to do that? Was that a contractual provision?

A Well, that's one thing that I was told that the U.S. Navy was demanding that I do or they would not let us continue with our work.

Q Was that a demand that was in writing or made orally?

A That was in writing, I believe. To the best of my knowledge.

Q When you say the Navy was requiring you to guarantee, what were they requiring you to guarantee?

A Well, they looked at the company, which they saw or felt was having economic problems, like most of the other shipbuilding companies in the country, and they said, you know, in order to continue or to get this contract you would have to have the guarantees. And I believe they even made it Mr. Steinbrenner's guarantee.

Q I'm sorry. Clarify that last remark.

A They would have to have guarantees of this money that they knew that we would be able to--I believe they said it had to be--well, there were no bank lines open to us. It would have to be Mr. Steinbrenner, if I'm not mistaken. That was my recollection of what was required.

Q I want to go back to Mr. Ragan and Mr. Magliocchetti for a couple additional questions.

A Sure.

Q In connection with this Navy oiler contract, all aspects, from the time you submitted the bid right through the appropriation phase, do you know if Mr. Ragan met with or spoke to any Navy officials above the program officer level regarding this contract?

A Whether he--I do not have the knowledge other than the times that, you know, I told you he went in that one time.

Q That's with Congress.

A Yes.

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Q Is there a time--

A He took--

Q Was there a time that he went with you to the Navy also?

A There was--no. He took me to the Pentagon, and then he waited outside on one occasion when I went in to meet with them. I believe he went in to one meeting. It was in the original meeting with Captain Todd and when Anselmi was there, but then when I stayed after, he had left.

Q Is that the meeting where Todd suggested that you look for Mr. Nierenberg?

A Well, I asked for his suggestions. I must make it clear. Mr. Todd did not say go hire this man and you'll be all right. He said, I would suggest some names to you. I don't like to, but, he said, I might suggest for you to entertain that Alan Nierenberg might be a very good name.

Q Did Mr. Ragan set up that meeting?

A No. I believe Mr. Anselmi set up that meeting.

Q Did Mr. Ragan set up any other meetings for you at the Pentagon?

A Not that I can recall, no.

Q Did he ever relate to you any discussions he had with any officials from the Navy regarding this contract?

A Not that I can recall.

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Q Did your people, any of your employees, ever relate to you conversations that they had had with Mr. Ragan in connection with contacts or communications he had had with people at the Navy?

A If they did, I don't recall them. I just don't recall any such conversations.

Q Now, did Mr. Magliocchetti ever meet with or speak to any officials from the Navy in connection with the Navy oiler contract on your company's behalf?

A I don't know that he ever did, no.

Q Did you ever attend a meeting at the Navy with Mr. Magliocchetti?

A I think he was at that meeting when Mr. Cann, Jerry Cann, had us all in there. I think that Mr. Magliocchetti went in because that was part of it.

Q Was Mr. Ragan at that meeting also?

A I don't believe so, no, sir.

Q You had said earlier that Mr. Magliocchetti was in the same office suite with Mr. Ragan?

A I think at the outset, way before that, he was in the same building. It was kind of--Bill Ragan had kind of a floor, and I think part of that floor he subleased to him or something, because that's the way I recall it. That was early on.

Q Were they in business together at the time, do you

know?

A I don't know that. I don't know that. They may have been.

Q When was the last time you had any communication with Mr. Ragan?

A Maybe two or three years ago, that I can recall. Can we turn that off a minute?

MR. DAMELIN: Yes.

[Discussion off the record.]

THE WITNESS: Well, the last time that I believe I saw him was at the funeral of Admiral Butcher, and I had forgotten that.

BY MR. DAMELIN:

Q Which was when?

A That was a couple years ago.

Q When was the last time you had either seen or had any communications with Mr. Magliocchetti?

A Today.

Q Earlier this morning?

A Yes. He has remained a friend, merely to pick me up at the airport and bring me here. That was my communication.

Q Have you used Mr. Magliocchetti for any services since you utilized his services in connection with the Navy oiler contract?

A I don't believe so, no, sir. We've remained friends, if you call picking me up at the airport and driving me somewhere, having lunch together or something, that's what it--

Q But you have not retained him for any function--

A I don't think he's been on a retainer with us for some time.

Q Had Mr. Ragan done anything for you subsequent to the Navy oiler contract?

A Well, I believe he did stay--we stayed in touch with him on some matters. You mean since the settlement? In the last 2 years--

Q No. Since the Navy oiler contract.

A He did a lot of work for us during those periods, but you have to understand, our people would call upon him. You know, I wouldn't know if they called him. For me, personally, did I see him? As I say, the last time I saw him was about 2 years ago. Subsequent to getting those contracts, I think he probably still did work for us, yes.

Q On other matters?

A On other matters or even on the matters that we were involved with at the time.

Q Your relationship with Mr. Ragan, your professional relationship, was he on a retainer to the companies?

A He was on a retainer to the companies, and--yes, yes.

Q Was that a monthly retainer?

A At times it was. At other times it was on the basis of when we could pay because of the problems we were going through.

Q How much was he paid a month on a retainer?

A I don't know that, sir. I just don't know, when he had the retainer. I don't know that.

MR. DAMELIN: As I said earlier, we do want that information.

MR. BURNS: That will be provided to you pursuant to your earlier request.

MR. DAMELIN: Okay. Just one second.

[Pause.]

MR. DAMELIN: Okay. I think that completes our questions.

MR. BANKER: Let me briefly clarify one thing here, and that had to do with my objection to confidentiality. What that is, we have two contracts. We have a contract to sell, which may or may not close on Tuesday. But we also have a back-up contract, and that back-up contract is confidential. Therefore, George just couldn't go into that. We're certainly not trying to hide the fact that--we believe that this yard is going to be

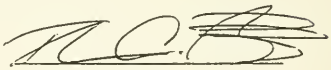
sold, but there are certainly no guarantees. Okay? So that's what the confidentiality was.

MR. DAMELIN: Okay.

[Whereupon, at 2:16 p.m., the taking of the deposition was concluded.]

CERTIFICATE OF NOTARY PUBLIC

I, THOMAS C. BITSKO, the officer before whom the foregoing deposition was taken, do hereby testify that the witness whose testimony appears in the foregoing deposition was duly sworn by me; that the testimony of said witness was taken by me stenographically and thereafter reduced to typewriting under my direction; that said deposition is a true record of the testimony given by said witness; that I am neither counsel for, related to, nor employed by and of the parties to the action in which this deposition was taken; and further, that I an not a relative or employee of any attorney or counsel employed by the parties hereto nor financially or otherwise interested in the outcome of the action.



THOMAS C. BITSKO

Notary Public in and for
the District of Columbia

My commission expires: June 30, 1998

DEPARTMENT OF THE NAVY
NAVAL SEA SYSTEMS COMMAND
WASHINGTON DC 20362-5101

4200
OPR: 02231
Ser 02/ 359
16 July 1992

EXHIBIT
Steinbrenner Dep
5/26/95

Tampa Shipyards, Inc.
P.O. Box 1277
Tampa, Florida 33601

Dear Mr. Nierenberg,

On 26 May 1992, Tampa Shipyards, Inc. (Tampa) requested Extraordinary Contractual Relief under Public Law 85-804. Subsequently, Mr. George Steinbrenner initiated a study by Paul Magliocchetti Associates (PMA) of selected Tampa activities. Mr. Steinbrenner requested that the Assistant Secretary of the Navy (Research, Development and Acquisition), Mr. Gerald Cann, withhold a final decision on the Public Law 85-804 request until the PMA study was completed and evaluated by NAVSEA.

NAVSEA has finished its analysis of Tampa's Public Law 85-804 request along with the changes proposed in the PMA study as well as changes proposed during the meetings between NAVSEA and PMA. A summary prepared by PMA of planned revisions to the Public Law 85-804 request is attached. Based on NAVSEA's analysis of Tampa's original request and PMA's revision, there do not appear to be adequate assurances to the Navy that, even if relief is granted, Tampa can complete performance of the contract.

If Tampa desires to submit a certified update to the original Public Law 85-804 submission, NAVSEA will defer its final decision. Otherwise, NAVSEA will make its decision based on the previously certified submission. Related to this decision is NAVSEA's observation that insufficient progress is being made towards the contractual delivery dates for T-AOs 191 and 192. Accordingly, Tampa is requested to provide notification as to its intentions with regard to updating its Public Law 85-804 request no later than 24 July.

Sincerely,

E.B. HARSHBARGER
Rear Admiral, SC, U.S. Navy
Deputy Commander for Contracts

Copy to:
Mr. George M. Steinbrenner

Attachment

REID & PRIEST LLP
A NEW YORK REGISTERED LIMITED LIABILITY PARTNERSHIP
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WASHINGTON OFFICE
DIRECT DIAL NUMBER

June 2, 1995

EXHIBIT # 33

DELIVERY BY HAND

Thomas C. Weller, Jr.
c/o Dyer, Ellis, Joseph & Mills
Watergate - Suite 1000
600 New Hampshire Avenue, N.W.
Washington, D.C. 20037

Dear Mr. Weller:

At your request, we have reviewed our billing files to ascertain the amount of fees we billed Pennsylvania Shipbuilding Company (PennShip) for lobbying work done in connection with the TAO contract.

Our analysis was based on a review of Reid & Priest's billing files from December 3, 1984 (the date we joined Reid & Priest after leaving our former firm, Butler & Binion) through March 1989, when our work for PennShip was essentially completed. This included a review of computer printouts with daily time entries, except for three months (January 1986, November 1986 and May 1988) for which computer printouts were unavailable. For these three months, an estimate was made based on the level of TAO activity during that particular period.

Based on our review, our best estimate of our fees is as follows:

Period	Estimated Fees
Dec. 1984	$ 5,685
1985	79,917
1986	12,576
1987	48,567
1988	79,180
1989	221

With regard to our work prior to December 3, 1984, when we were at Butler & Binion, we have copies of the firm's invoices to PennShip for March 16 through June 30, 1984 and November 1 through November 30, 1984, but have been unable to locate any back-up records showing the specific work done on each day during these months. Moreover, we have not been able to locate, in either our files or Butler & Binion's files, the Butler & Binion invoices or the detailed billing records for July through October 1984. I have called one of my former partners at Butler & Binion to find out if the firm retained the PennShip billing files. He had a search done of the files in storage, but was unable to locate any PennShip files and believes that they have been discarded. In any event, the Butler & Binion invoices for work done from March 16 to June 30, 1984 do not mention the TAO matter. The Butler & Binion invoice for November 1984, which shows total fees of $7,151.25, does mention the TAO matter. Based on the nature of the work done in December 1984 at Reid & Priest, a large portion, perhaps 80 percent, of the November 1984 effort may have been lobbying work in connection with the TAOs.

I hope this information meets your needs. If I can be of any further assistance, please call me.

Sincerely,

Richard J. Leidl

RJL:dbc

Select Committee on Investigations
EXHIBIT # 37

Pennsylvania Shipbuilding

Pennsylvania Shipbuilding Company • P.O. Box 498 • Chester, PA 19016 • (215) 499-2000 • TELEX 834226

HOTLINE ALLEGATION
CONCERNING CONSTRUCTION OF
TAO 187 CLASS TANKERS
PROJECT NO. 3CA-8017

Submitter requests at least ten (10) days prior notice of any USG/DOD intent to disclose pursuant to any FOIA request. Submitter further requests, in that event, opportunity to submit memoranda of reasons for nondisclosure.

March 15, 1985

HAND DELIVERED

Mr. Christopher Pigott
Financial Analyst
Naval Sea Systems Command
National Center #3
Room 5E58
Arlington, Virginia 20362

Re: T-AO 187 Fleet Oiler Program; Further Clarification of Pre-Award Survey Questions

Dear Mr. Pigott:

Since the commencement of the captioned procurement and, particularly, during the last two months in response to a series of questions raised in the Navy's pre-award survey, we have provided the Navy with a substantial amount of information establishing that Penn Ship is fully "responsible" in that it possesses the capability and financial strength to perform under a T-AO contract.

We provided further information in my letter dated February 25, 1985 to you in response to the Navy's specific concerns over Penn Ship's financial strength in the highly unlikely event of significant cost overruns on a T-AO contract. Included with that letter was an internal company memorandum prepared by Ron Stevens, Penn Ship's Chief Financial Officer (Attachment 1.). Mr. Stevens' memo analyzes in

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detail certain basic assumptions underlying our T-AO bid and concludes that extraordinary events would have to take place for Penn Ship to incur substantial out-of-pocket losses. He further concludes that even such losses could be covered out of other yard activities and, in the event they could not, that the yard's substantial asset base would be more than adequate for this purpose. We have previously indicated to you that there are additional assets in Penn Ship's affiliates which are also available for this purpose.

We have now taken our equity in that asset base (Attachment 2.) and placed it in an irrevocable trust with Fidelity Bank, National Association, a major Philadelphia financial institution ("Trustee") (Attachment 3). The trust gives the Trustee (i) a security interest and/or mortgage in the entire Penn Ship facility (Attachments 4.-6.) and (ii) a security interest and/or mortgage in certain assets of Penn Ship's affiliates (Attachments 6.-8.). These security interests and mortgages segregate for the account of the Navy $20 million in assets, consisting of both real and personal property. The funds from the liquidation of those assets would be used by the Trustee to satisfy Penn Ship's financial obligations to the Navy under a T-AO contract in the event that Penn Ship is otherwise unable to do so.

Mr. Stevens' memorandum, which assumed a four-ship award (two FY 1985 ships and one option ship in each of FY 1986 and FY 1987), showed that Penn Ship could easily handle any cost overruns. To provide the Navy even further protection, we have made the Trust, the mortgages and the security agreements effective even upon a three-ship award (i.e., two ships in FY 1985 and one or more option ships in FY 1986 and/or FY 1987). By taking this step, Penn Ship has protected at least $20 million in assets from other creditors to assure the availability of funds to meet overruns. We strongly believe that this segregation of assets under the Trust will lay to rest any questions of the pre-award survey team concerning Penn Ship's financial responsibility under a T-AO contract.

The security interest/mortgage being provided by Penn Ship and its affiliate company, Delaware Drydock & Ship Repair Company, consists of a second position on the entire shipyard, comprising about 180 acres of property, over one million square feet of buildings, over one mile of frontage

on the Delaware River, and all machinery and equipment in the yard. Penn Ship is also providing a security interest consisting of a second preferred position in its 800-ton capacity floating crane that is the largest commercially available such crane on the Atlantic Coast. The shipyard and its assets, including the floating crane, are described in more detail in an accompanying document. A second document provides a summary of values (Attachment 2.).

The security interest being provided by the Capital Marine Corporation subsidiary (Marine and Offshore Equipment Leasing Company) is a second preferred position on a floating dry dock that has a 70,000-ton lifting capacity and is one of the largest dry docks in the United States.

This segregation of assets is accomplished through the attached legal documents and is summarized and explained in the attached descriptive materials, as follows:

1. Summary of an internal memorandum regarding Penn Ship's ability to absorb various hypothetical out-of-pocket cost overruns. A copy of that underlying memorandum, dated February 22, 1985, is also attached.

2. Description and valuation of assets pledged to the Navy:

   a. Overall Description of Assets;

   b. Valuation of Principal Properties Comprising the Yard;

   c. Independent Appraisal by Crandall Dry Dock Engineers, Inc. of Floating Dry Dock No. 4;

   d. Independent Appraisal by United States Salvage Associates, Inc. of the 800-Ton Capacity Floating Crane and Descriptive Brochure;

   e. General Yard Building Plans;

   f. Penn Ship General Yard Plan;

   g. Penn Ship's Real Estate Maps; and,

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h. Aerial Photograph of Penn Ship Facilities.

3. Trust Indenture between Penn Ship and Fidelity Bank, National Association ("Trustee");

4. Mortgage from Penn Ship to the corporate Trustee providing a security interest/mortgage in the Penn Ship Chester, Pennsylvania yard to the corporate Trustee for the benefit of the Navy;

5. Second Preferred Ship Mortgage from Penn Ship to the corporate Trustee providing a mortgage in an 800-ton capacity floating crane (largest commercially available floating crane on the East Coast) to the corporate Trustee for the benefit of the Navy;

6. Security Agreement between Penn Ship and Delaware Drydock & Ship Repair Company ("Delaware") and the corporate Trustee providing a security interest in the fixtures and equipment of Penn Ship and Delaware to the Trustee on behalf of the Navy;

7. Mortgage from Delaware to the corporate Trustee providing a security interest in the principal asset (70,000-ton floating dry dock) of Delaware to the corporate Trustee for the benefit of the Navy; and,

8. Security Agreement between Maritime and Offshore Equipment Leasing Company and the corporate Trustee providing a security interest in a 700-foot floating dry dock to the corporate Trustee for the benefit of the Navy.

I appreciate that the pre-award survey team has had a great volume of information to digest. However, in light of the questions raised by the pre-award survey team, this information was necessary to confirm that Penn Ship possesses the resources and assets to carry out its contractual obligations to the Navy in all events.

Should you or other members of the pre-award survey team have any further questions, we respectfully request

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the immediate opportunity to respond and thus resolve any remaining issues.

Sincerely,

T. C. Weller, Jr.
Chairman

TCW,Jr.:tsl

Attachments

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